

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

OR

☐ TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report _____

Commission file number 0-30324

RADWARE LTD.

(Exact name of Registrant as specified in its charter)

Israel

(Jurisdiction of incorporation or organization)

22 Raoul Wallenberg Street, Tel Aviv 69710, Israel
(Address of principal executive offices)

| | |
|---|--|
| Securities registered or to be registered pursuant to Section 12(b) of the Act: | |
| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
| Ordinary Shares, NIS 0.1 par value per share | NASDAQ Global Market |

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer’s classes of capital or common stock as of the close of the period covered by the annual report:

19,411,903 Ordinary Shares, NIS 0.1 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ Yes ☒ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐

Indicate by check mark which financial statement item the registrant has elected to follow.

☐ Item 17 ☒ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

☐ Yes ☒ No

INTRODUCTION

As used in this annual report, the terms “we,” “us,” “our,” the “Company,” and “Radware” mean Radware Ltd. and its subsidiaries, unless otherwise indicated. The references to "Companies Law" or the “Israeli Companies Law” are to the Israeli Companies Law, 5759-1999 (as amended).

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Except for the historical information contained herein, the statements contained in this annual report are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our business, financial condition and results of operations. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in “Risk Factors” and elsewhere in this annual report.

We urge you to consider that statements which use the terms “believe,” “do not believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate,” and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

We have registered trademarks for “Web Server Director®,” “Cache Server Director®”, “FireProof®”, “LinkProof®”, “Triangulation®”, “Smart Nat®”, “Get Certain®”, “CertainT®”, “Peer Director®”, “Synapps Architecture®”, “DefensePro®”, “StringMatch Engine®” and “CID - Content Inspection Director®” and we have trademark applications pending for “UpLink™”, “Radware™”, “APSolute™”, “AppDirector”™, “AppXCel”™, “SecureFlow”™, “SOADirector”™, “SOASwitch”™, “SIPDirector”™ and “DFI- Deep Flow Inspection”™. All other trademarks and tradenames appearing in this annual report are owned by their respective holders.

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PART I

ITEM 1. Identity of Directors, Senior Management and Advisors

Not applicable.

ITEM 2. Offer Statistics and Expected Timetable

Not applicable.

ITEM 3. Key Information

Selected Financial Data

The following tables present our consolidated statement of operations and balance sheet data for the periods and as of the dates indicated. We derived the statement of operations for the years ended December 31, 2004, 2005 and 2006 and the balance sheet data as at December 31, 2005 and 2006 from our audited consolidated financial statements included elsewhere in this annual report, which have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”). The selected consolidated statement of operations financial data for the years ended December 31, 2002 and 2003 and the balance sheet data for the years ended December 31, 2002, 2003 and 2004 are derived from our audited consolidated financial statements not included in this annual report, which have been prepared in accordance with U.S. GAAP. *You should read the following selected financial data together with the section of this annual report entitled “Operating and Financial Review and Prospects” and our consolidated financial statements together with the notes thereto included elsewhere in this annual report.* Please see notes 2Q and 12B of the notes to our consolidated financial statements for an explanation regarding the computation of basic and diluted net earnings (loss) per ordinary share.

| | Year ended December 31, 2002 | Year ended December 31, 2003 | Year ended December 31, 2004 | Year ended December 31, 2005 | Year ended December 31, 2006 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| (US \$ in thousands, except per share data) | | | | | |
| Statement of Operations Data: | | | | | |
| Revenues | \$ 43,663 | \$ 54,780 | \$ 68,439 | \$ 77,584 | \$ 81,410 |
| Cost of revenues | 7,946 | 9,854 | 12,184 | 14,896 | 15,791 |
| Gross profit | 35,717 | 44,926 | 56,255 | 62,688 | 65,619 |
| Operating expenses: | | | | | |
| Research and development, net | 7,809 | 8,398 | 10,342 | 13,017 | 17,659 |
| Sales and Marketing | 30,019 | 29,753 | 31,898 | 40,002 | 50,128 |
| General and administrative | 4,219 | 4,120 | 4,493 | 5,244 | 6,178 |
| Total operating expenses | 42,047 | 42,271 | 46,733 | 58,263 | 73,965 |
| Operating profit (loss) | (6,330) | 2,655 | 9,522 | 4,425 | (8,346) |
| Financial income, net | 4,240 | 3,740 | 4,565 | 5,159 | 7,422 |
| Income (loss) before income taxes | (2,090) | 6,395 | 14,087 | 9,584 | (924) |
| Income taxes | - | - | (341) | (240) | (356) |
| Minority interest in losses (earnings) of a subsidiary | (23) | (40) | 34 | - | - |
| Net income (loss) | \$ (2,113) | \$ 6,355 | \$ 13,780 | \$ 9,344 | \$ (1,280) |
| Basic net earnings (loss) per share | \$ (0.13) | \$ 0.37 | \$ 0.77 | \$ 0.50 | \$ (0.07) |
| Diluted net earnings (loss) per share | \$ (0.13) | \$ 0.34 | \$ 0.70 | \$ 0.47 | \$ (0.07) |

| | Year ended December 31, 2002 | Year ended December 31, 2003 | Year ended December 31, 2004 | Year ended December 31, 2005 | Year ended December 31, 2006 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| | (in thousands) | | | | |
| Weighted average number of ordinary shares used in computing basic net earnings (loss) per share | 16,655 | 17,184 | 17,995 | 18,800 | 19,325 |
| Weighted average number of ordinary shares used in computing diluted net earnings (loss) per share | 16,655 | 18,666 | 19,805 | 20,072 | 19,325 |

| | 2002 | 2003 | December 31, 2004 | 2005 | 2006 |
|--|----------------------|------|----------------------|------|------|
| | (US \$ in thousands) | | | | |

Balance Sheet Data:

| | | | | | |
|---|-----------|-----------|------------|------------|------------|
| Cash and cash equivalents, short-term bank deposits and marketable securities and current maturities of long-term bank deposits | \$ 52,274 | \$ 62,882 | \$ 109,020 | \$ 126,901 | \$ 140,375 |
| Long-term bank deposits, structured note and marketable securities | 73,027 | 76,139 | 48,021 | 37,592 | 23,756 |
| Working capital | 50,690 | 60,477 | 107,687 | 124,005 | 137,406 |
| Total assets | 142,998 | 158,114 | 183,241 | 204,347 | 215,668 |
| Shareholders’ equity | 127,357 | 140,246 | 160,917 | 177,426 | 182,414 |

Risk Factors

Our business, operating results and financial condition could be seriously harmed due to any of the following risks. The following risks are not the only risk factors facing our Company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. The trading price of our ordinary shares could decline due to any of these risks.

Risks Related to Our Business and Our Industry

We have incurred losses in the past, and may incur losses in the future

While we were profitable in each of the years 2003-2005, we incurred losses in 2002 and 2006. We had net loss of approximately \$1.3 million in 2006, and net income of \$9.3 million in 2005, \$13.8 million in 2004 and \$6.4 million in 2003. We incurred net losses of approximately \$2.1 million in 2002. We will need to generate increased revenues as well as manage our costs to return to and maintain profitability. In 2006 we incurred losses as a result of increased expenses incurred in our efforts to significantly increase our revenues, coupled with only moderate revenue growth for the year, mainly due to the inability of our US sales force to ramp up sales in the Americas. We cannot assure you that we will be able to return to or maintain profitability. Our gross margin is currently approximately 81%. As a result, any decrease in sales may have a significant effect on our profitability.

Our revenues may not grow or continue at their current level. For example, the growth rate in 2004 compared to 2003 was approximately 25%, whereas the growth rate in 2005 compared to 2004 was approximately 13% and the growth rate in 2006 compared to 2005 was approximately 5%. In addition, our operating expenses may continue to increase. Our decision to increase operating expenses and the scope of such increase will depend upon several factors, including the market situation and the results that our past expenditures produce. We may continue to make additional expenditures in anticipation of generating higher revenues, which we may not realize, if at all, until some time in the future. For example, during 2006 we restructured our sales force in the United States in an effort to increase the effectiveness of our sales efforts in this market. Our efforts as well as our expenditures in this restructuring may not result in increased revenues. If our revenues continue not to increase as anticipated, or if our expenses increase at a more rapid pace than revenues, we may continue to incur losses.

Our results for 2006 were benefited by financial income in an amount of approximately \$7.4 million. We cannot assure you that we will be able to generate financial income in the future or that such financial income will remain at the same level.

Volatility of the market for our products, including slow-down in expenditures by service providers, e-commerce businesses and other trends in our industry could have a material adverse effect on our results of operations.

Our business is dependent on current and anticipated market demand for our products. Beginning in late 2000, market demand was negatively impacted by the general deterioration of the global economy and the economic uncertainties in the telecommunications market. These conditions, and the uncertainties surrounding the growth rates of economies worldwide, resulted in a curtailment of capital investment by companies in our target markets and caused our revenue growth to increase at a significantly slower pace during 2001 and 2002 relative to prior years. According to our estimates, in 2003, the market remained substantially flat and in 2004 through 2006 there was an improvement in the market. Due to the past volatility of the market it is difficult to predict the conditions of our market going forward. In addition, we believe that market conditions could cause our customers and potential customers to be more conservative in planning their spending. If the global conditions deteriorate, and companies in our target markets reduce capital expenditures, we may experience a reduction in sales, as well as downward pressure on the price of our products. In addition, if the market is flat and customers experience low visibility we may not be able to increase our sales. Each of the above scenarios would have a material adverse effect on our business, operating results and financial condition.

We may experience significant fluctuations in our quarterly financial performance because of the factors discussed below and seasonal fluctuations in our sales.

Our quarterly operating results have varied significantly in the past and may vary significantly in the future as a result of various factors, many of which are outside of our control. These factors include:

- Our limited order backlog;
- Our need to develop and introduce new and enhanced products; and
- The long sales cycles of our products.

As a result of the foregoing our results in any quarter may also fall below projected results. For example, in the first quarter of 2007 our revenues were approximately \$1.5 million less than projected at the beginning of the quarter.

In addition, our quarterly operating results have been, and are likely to continue to be, influenced by seasonal fluctuations in our sales. Because our sales have grown significantly since inception, these fluctuations may not be apparent from our historical financial statements. However, we believe that our sales and sales growth have been, and will continue to be, affected by the seasonal purchasing patterns of some of our customers. For example, we believe that our sales may be reduced from the levels which we might otherwise have been able to attain during the third quarter of 2007 because of the slowdown in business activities during the summer months in Europe, and that our sales during the fourth quarter of 2007 may be increased because some of our customers tend to make greater capital expenditures towards the end of their own fiscal years. Because of these anticipated fluctuations, our sales and operating results in any quarter may not be indicative of future performance and it may be difficult for investors to properly evaluate our prospects.

If the market for Application Delivery and Network Security solutions does not continue to develop, we will not be able to sell enough of our products to achieve and maintain profitability.

The Application Delivery and Network Security markets in which we operate are rapidly evolving and we cannot assure you that they will continue to develop and grow or that our products and technology will keep pace with these changes. Market acceptance of Application Delivery and Network Security solutions may be inhibited by, among other factors, a lack of anticipated congestion and strain on existing network infrastructures and the availability of alternative solutions. If demand for Application Delivery and Network Security solutions does not continue to grow, we may not be able to sell enough of our products to achieve, maintain and increase profitability.

Competition in the market for Application Delivery and Network Security solutions is intense. As a result, we may lose market share and we may be unable to achieve and maintain profitability.

The Application Delivery and Network Security markets are highly competitive and we expect competition to intensify in the future. We may lose market share if we are unable to compete effectively with our competitors. Our principal competitors in the Application Delivery solutions market include: F5 Networks, Inc., Cisco Systems, Inc., Citrix Systems, Inc. Foundry Networks, Inc., and Juniper Networks, Inc. In addition, we face competitors in the Network Security space, with respect to our Intrusion Prevention Systems (IPS). Such principal competitors include Juniper Networks, Inc., 3Com Systems, Inc. (TippingPoint), McAfee, Inc., Sourcefire, Inc., and IBM Corporation (Internet Security Systems). We expect to continue to face additional competition as new participants enter the market. Larger companies with substantial resources, brand recognition and sales channels may form alliances with or acquire competing Application Delivery or Network Security solutions and emerge as significant competitors. For example, IBM Corporation became a competitor in the Network Security market by acquiring Internet Security Systems (ISS). Competition may result in lower prices or reduced demand for our products and a corresponding reduction in our ability to recover our costs, which may impair our ability to achieve, maintain and increase profitability. Furthermore, the dynamic market environment, which is demonstrated by the above acquisitions, poses a challenge in predicting market trends and expected growth.

Most of our competitors have greater resources than us, which may limit our ability to effectively compete with them.

Most of our competitors have greater financial, personnel and other resources than us, which may limit our ability to effectively compete with them. These competitors may be able to:

- respond more quickly to new or emerging technologies or changes in customer requirements;
- benefit from greater economies of scale;
- offer more aggressive pricing;
- devote greater resources to the promotion of their products; and/or
- bundle their products or incorporate an Application Delivery or Intrusion Prevention component into existing products in a manner that renders our products partially or fully obsolete.

We must develop new products and enhancements to existing products to remain competitive. If we fail to develop new products and product enhancements on a timely basis, we may lose market share.

The markets for Application Delivery and Network Security solutions are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Accordingly, our future success will depend to a substantial extent on our ability to:

- invest significantly in research and development;
- develop, introduce and support new products and enhancements on a timely basis; and
- gain and consecutively increase market acceptance of our products.

We are currently developing new products and enhancements to our existing products. We may not be able to successfully complete the development and market introduction of new products or product enhancements. If we fail to develop and deploy new products and product enhancements on a timely basis, or if we fail to gain market acceptance of our new products, our revenues will decline and we may lose market share to our competitors. For example, during 2006, we introduced additions to our next generation APSolute application delivery product family. During 2006, we also invested, and plan to continue to invest in 2007, in developing or when appropriate, acquiring, capabilities to advance our APSolute product family and market vision for application-smart networking. As evidence of 2007 investments, we acquired Covelight Systems, Inc. (“Covelight”) in April for their web channel intelligence technology that allows business events to be captured in real-time on the network. This strategic move is intended to increase the market relevance of our APSolute product portfolio. We also released v3.10 of our DefensePro software with support for IPv6 and worm propagation prevention and added web application firewall (WAF) services to our AppXcel service platform through an OEM partnership with Imperva. These investments are part of our new positioning initiative branded as “business-smart networking”. There is no assurance that we will be successful in marketing and selling our next generation Application Delivery and Network Security solutions or the Covelight solutions, or that we will be able to grow revenues to justify our investments.

We may make acquisitions or pursue mergers that could disrupt our business and harm our financial condition.

As part of our business strategy, we may invest in or acquire other businesses, technologies or assets, or we may enter into joint ventures or other strategic relationships with third parties. For example, in the last two years we acquired the businesses of V-Secure and Covelight. We may assume liabilities or write-offs, incur amortization expenses related to intangible assets or realize large and immediate write-offs in connection with future acquisitions. In addition, the future valuation of these acquisitions may decrease from the market price paid by us, which may result in the writing-off, or impairment, of the relevant assets. In addition, our operation of any acquired or merged businesses, technologies or assets could involve numerous risks, including:

- Post-merger integration problems resulting from the combination of any acquired operations with our own operations or from the combination of two or more operations into a new merged entity;
- Diversion of management’s attention from our core business;
- Substantial expenditures, which could divert funds from other corporate uses;
- Entering markets in which we have little or no experience; and
- Loss of key employees of the acquired operations.

We cannot be certain that our recent acquisitions or any future acquisition or merger will be successful. If the operation of the business of any recent or future acquisitions or mergers disrupts our operations, our business may suffer. In addition, even if we successfully integrate the acquired business with our own, we may not receive the intended benefits of the acquisition.

We have a very limited order backlog. If revenue levels for any quarter fall below our expectations, our earnings will decrease.

We have a very limited order backlog, which makes revenues in any quarter dependent on orders received and delivered in that quarter. A delay in the recognition of revenue may have a significant negative impact on our results of operations for a given period. We base our decisions regarding our operating expenses on anticipated revenue trends, and our expense levels are relatively fixed, or require some time for adjustment. Because only a small portion of our expenses varies with our revenues, if revenue levels fall below our expectations, our earnings will decrease.

We depend upon independent distributors to sell our products to customers. If our distributors do not succeed in selling our products, our revenues will suffer.

We sell our products primarily to independent distributors, including value added resellers, original equipment manufacturers and systems integrators. These distributors resell our products to the ultimate customers. We currently have over 200 active independent distributors and resellers that sell our products. We are highly dependent upon our distributors’ active marketing and sales efforts. Our distribution agreements generally are non-exclusive, one-year agreements with no obligation on the part of our distributors to renew the agreements. Typically, our distribution agreements do not prevent our distributors from selling products of other companies, including products that may compete with our products, and do not contain minimum sales or marketing performance requirements. As a result, our distributors may give higher priority to products of other companies or to their own products, thus reducing or discontinuing their efforts to sell our products. We may not be able to maintain our existing distribution relationships. If our distributors terminate their relationships with us, we may not be successful in replacing them. In addition, we may need to develop new distribution channels for new products and we may not succeed in doing so. Any changes in our distribution channels, or our inability to establish distribution channels for new products, will impair our ability to sell our products and result in the loss of revenues.

Our products generally have long sales cycles, which increase our costs in obtaining orders and reduces the predictability of our earnings.

Our products are technologically complex and are typically intended for use in applications that may be critical to the business of our customers. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new equipment. The sales cycles of our products to new customers can last as long as twelve months from initial presentation to sale. This delays the time in which we recognize revenue, and results in our having to invest significant resources in marketing and sales.

Long sales cycles also subject us to risks not usually encountered in a short sales cycle, including our customers’ budgetary constraints and internal acceptance reviews and processes prior to purchase. In addition, orders expected in one quarter could shift to another because of the timing of our customers’ procurement decisions. Furthermore, customers may defer orders in anticipation of new products or product enhancements introduced by us or by our competitors. These factors complicate our planning processes and reduce the predictability of our earnings.

We must manage our anticipated growth effectively in order to achieve profitability.

We have actively expanded our operations in the past and may continue to expand them in the future in order to gain market share in the evolving market for Application Delivery and Network Security solutions. This expansion has required, and may continue to require, managerial, operational and financial resources.

We cannot assure you that we will continue to expand, or that we will be able to offer and expand our operations successfully. If we are unable to manage our expanding operations effectively, our revenues may not increase, our cost of operations may rise and we may not be profitable.

As we grow we may need new or enhanced systems, procedures or controls. For example, at the beginning of 2007, we implemented a company-wide Oracle ERP system, with a substantial investment of resources, in order to increase our efficiencies of our operations in the fields of finance, operations, customer support and order management. The transition to new systems, procedures or controls, as well as any delay in transitioning to new or enhanced systems, procedures or controls, may seriously harm our ability to accurately forecast sales demand, manage our product inventory and record and report financial and management information on a timely and accurate basis.

Our international sales may expose us to additional risks

We currently offer our products in over 40 countries in addition to the United States. In fiscal years 2005 and 2006 our sales outside the Americas represented approximately 59% and 66%, respectively, of our total sales. Our international business activity involves varying degrees of risk and uncertainty inherent in doing business in so many different jurisdictions. Such risks, among others, may include: the possibility of unfavorable circumstances arising from host country laws or regulations, including unexpected changes of interpretations thereof; partial or total expropriation; export duties and quotas; local tax exposure; insurrection or war; and differences in business practices. For example, we are required to comply with European Union Directives with respect to product quality assurance standards and environmental standards. In 2006, we were required to modify certain of our products in order to comply with Directive 2002/95/EC on Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (known as the “RoHs” Directive), which requires products sold in Europe to meet certain design specifications. We incurred costs and expenses and were required to spend management time and resources in the redesign of our products to meet the RoHs Directive.

Currency exchange rates and fluctuations of exchange rates could have a material adverse effect on our results of operations.

We are impacted by exchange rates and fluctuations thereof in a number of ways, including:

- A significant portion of our expenses, principally salaries and related personnel expenses, are paid in Israel shekels, whereas most of our revenues are generated in dollars and Euros. We have recently witnessed a significant strengthening of the shekel against the dollar, which has considerably increased the dollar value of our expenses in Israel. Should the shekel continue to maintain, or increase, its strength in comparison to the dollar, the dollar value of these expenses will continue to be high, and our results of operations will be adversely affected.
- A portion of our international sales are denominated in currencies other than dollars, such as the Euro, thereby exposing us to gains and losses on non-U.S. currency transactions.
- A substantial proportion of our international sales are denominated in dollars. Accordingly, devaluation in the local currencies of our customers relative to the dollar could cause customers to decrease orders or default on payment, which could harm our results of operations.

Our success depends on our ability to attract, train and retain highly qualified sales, technical and customer support personnel.

As we grow, we may need to increase our research and development, sales and marketing, and support staff. Our products require a sophisticated marketing and sales effort targeted at several levels within a prospective customer's organization. The integration of these solutions into existing networks and ongoing support can be complex. Accordingly, we need highly-trained sales, marketing and customer support personnel. Competition for qualified sales personnel, as well as technical and customer support personnel is intense, and we may not be able to hire sufficient personnel to support our research and development and sales and marketing efforts. Our success depends upon our ability to attract, train and retain highly qualified personnel.

We are dependent on Roy Zisapel, our President and Chief Executive Officer, the loss of whom would negatively affect our business.

Our future success depends in large part on the continued services of our senior management and key personnel. In particular, we are highly dependent on the services of Roy Zisapel, our President and Chief Executive Officer. Although we have employment contracts with our senior management and key personnel, we do not carry life insurance on our senior management or key personnel. Any loss of the services of Roy Zisapel, other members of senior management or other key personnel could negatively affect our business.

Undetected hardware defects and software errors may increase our costs and impair the market acceptance of our products.

Our products have occasionally contained, and may in the future contain, undetected defects or errors, especially when first introduced or when new versions are released, due to defects or errors we fail to detect, including in components supplied by third parties. These defects or errors may be found after the commencement of commercial shipments. In addition, our customers integrate our products into their networks with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the product that has caused the problem. Regardless of the source of these defects or errors, we will then need to divert the attention of our engineering personnel from our product development efforts to address the detection and correction of these errors and defects. In the past, we have not incurred significant warranty or repair costs, nor have we been subject to liability claims for damages related to product errors or defects nor experienced any material lags or delays as a result thereof. However, we cannot assure you that we will not incur these costs or liabilities or experience these lags or delays in the future. Any insurance policies that we may have may not provide sufficient protection should a claim be asserted. Moreover, the occurrence of errors and defects, whether caused by our products or the components supplied by another vendor, may result in significant customer relations problems and injure our reputation, thus impairing the market acceptance of our products.

We rely on third-party manufacturing vendors to provide key components of our products. If USR Technologies and Electronics (2003) Ltd., or USR, is not able to provide us with adequate supplies of the principal component used in our products, we may not be able to deliver sufficient quantities of our products to satisfy demand, or may have a delay in fulfilling orders.

We rely on USR to supply us with circuit boards. These circuit boards are a principal component, which we use in the manufacture of our products. If we are unable to acquire circuit boards from USR on acceptable terms, or should USR cease to supply us with circuit boards for any reason, we may not be able to identify and integrate an alternative source of supply in a timely fashion or at the same costs. Any transition to one or more alternate suppliers would likely result in delays, operational problems and increased costs, and may limit our ability to deliver our products to our customers on time for such transition period. We entered into agreements with two additional suppliers, but to date have only purchased relatively small quantities from those suppliers. If we would need to rely on the alternate suppliers, there is no assurance that we will be able to obtain the quantities we require at lead times and pricing competitive to USR.

A shortage of components or manufacturing capacity could cause a delay in our ability to fulfill orders or increase our manufacturing costs

Our growth and ability to meet customer demands depend in part on our ability to obtain timely deliveries of parts from our suppliers and contract manufacturers. We may experience a shortage of certain component parts as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers, or strong demand in the industry for those parts, especially if the economy grows. Growth in the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and component demands within specific product categories and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all, and we may also encounter shortages if we do not accurately anticipate our needs. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner in the quantities or configurations needed. Accordingly, our revenues and gross margins could suffer until other sources can be developed. Our operating results would also be adversely affected if, anticipating greater demand than actually develops, we commit to the purchase of more components than we need. There can be no assurance that we will not encounter these problems in the future. Although in many cases we use standard parts and components for our products, certain components are presently available only from a single source or limited sources. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

Our profitability could suffer if third parties infringe upon our proprietary technology.

Our profitability could suffer if third parties infringe upon our intellectual property rights or misappropriate our technologies and trademarks for their own businesses. Our success depends upon the protection of our proprietary software installed in our products, our trade secrets and our trademarks. To protect our rights to our intellectual property, we rely on a combination of trademark and patent law, trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, distributors and others. In the United States, we have registered trademarks for “Web Server Director®,” “Cache Server Director®”, “FireProof®”, “LinkProof®”, “Triangulation®”, “Smart Nat®”, “Get Certain®”, “CertainT®”, “Peer Director®”, “Synapps Architecture®”, “DefencePro®”, StringMatch Engine®” and “CID - Content Inspection Director®”. We also have trademark applications pending for “UpLink™”, “Radware™”, “APSolute™”, “AppDirector”™, “AppXCell”™, “SecureFlow”™, “SOADirector”™, “SOASwitch”™, “SIPDirector”™ and “DFI- Deep Flow Inspection”™. In addition, we have registered patents in the United States for our triangle redirection method used for the global load balancing, for our mechanism for efficient management and optimization of multiple links used in our LinkProof product, for our method for load balancing by global proximity used in our WSD product and for our method for controlling traffic on links between autonomous BGP systems. We also have pending patent applications and provisional patents in connection with several features used in our products. The protective steps we have taken may be inadequate to deter misappropriation of our proprietary information. We may be unable to detect the unauthorized use of our proprietary technology or take appropriate steps to enforce our intellectual property rights. Effective trademark, patent and trade secret protection may not be available in every country in which we offer, or intend to offer, our products. Failure to adequately protect our intellectual property could devalue our proprietary content and impair our ability to compete effectively. Furthermore, defending our intellectual property rights could result in the expenditure of significant financial and managerial resources. For example, in 2004 we sued F5 networks Inc. for patent infringement and we settled in 2005. Although the lawsuit did not result in a significant expenditure we spent time and resources litigating and settling the claim.

Our products may infringe on the intellectual property rights of others.

Third parties may assert against us infringement claims or claims that we have violated a patent or infringed a copyright, trademark or other proprietary right belonging to them. As a result we may incur costs defending ourselves or settling lawsuits even if we believe we do not infringe third parties rights. For example, in 2003, F5 Networks, Inc. filed a lawsuit against us for patent infringement which was settled in 2004. The settlement included a license of the F5 patent.

Our non-competition agreements with our employees may not be enforceable in certain jurisdictions. If any of these employees leaves our Company and joins a competitor, our competitor could benefit from the expertise our former employee gained while working for us.

We currently have non-competition agreements with all of our employees. These agreements prohibit our employees, in the event they cease to work for us, from directly competing with us or working for our competitors for a limited period after termination of employment. The laws of the U.S., Israel and other countries in which we have employees, may limit or prohibit our ability to enforce these non-competition agreements, or may allow us to enforce them only to a limited extent. In the event that we are unable to enforce any of these agreements, competitors that employ our former employees could benefit from the expertise our former employees gained while working for us.

Some of our deposits and other investments may be in excess of insured limits and are not insured in other jurisdictions.

The majority of our cash and cash equivalents, and short-term and long-term bank deposits are invested in banks in the United States and the U.K.. Some of these deposits may be in excess of insured limits and are not otherwise insured. If one or more of these financial institutions were to become insolvent, the loss of these investments would have a material adverse effect on our financial condition.

Risks Related to the Market for Our Ordinary Shares

Two shareholders may exert significant influence in the election of our directors and over the outcome of matters requiring shareholder approval.

As of June 3, 2007, Mr. Yehuda Zisapel, a member of our Board of Directors, beneficially owned 13.57% of the ordinary shares outstanding and Roy Zisapel, our Chief Executive Officer, President and director, and Mr. Yehuda Zisapel's son beneficially owns approximately 5.18% of our ordinary shares outstanding (See "Item 6 - Share Ownership"). As a result, these shareholders may exert significant influence in the outcome of various actions that require shareholder approval, such as the election of our directors, and the approval or rejection of a merger and similar corporate transactions.

If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences.

Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we would be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our U.S. shareholders, including having gain realized on the sale of our ordinary shares treated as ordinary income, as opposed to capital gain income, and having potentially punitive interest charges apply to such sales proceeds. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares.

We reasonably believe we were not a PFIC for our 2006 tax year. It is possible that the Internal Revenue Service will attempt to treat us as a PFIC for 2006 or prior years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC in 2007 or in subsequent years. For a discussion of the rules relating to passive foreign investment companies and related tax consequences, please see the section of this annual report entitled “Item 10 - Additional Information - Taxation — United States Federal Income Tax Considerations.”

Risks Related to Operations in Israel

Conditions in Israel affect our operations and may limit our ability to produce and sell our products.

We are incorporated under Israeli law and our principal offices and manufacturing and research and development facilities are located in Israel. Accordingly, our operations and financial results could be adversely affected if political, economic and military events curtailed or interrupted trade between Israel and its present trading partners or if major hostilities involving Israel should occur in the Middle East.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a high level of violence between the Palestinians and Israel, which has strained Israel’s relationship with its Arab citizens, Arab countries and, to some extent, with other countries around the world. The establishment in early 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group created additional unrest and uncertainty in the region. In July and August 2006, an armed conflict has taken place between Israel and Hezbollah, an Islamic movement based in Lebanon, which included the firing of multiple rockets by Hezbollah throughout northern Israel as well as retaliatory attacks by Israel throughout Lebanon.

We do not believe that the political and security situation has had a material impact on our business to date, however, there is no assurance that this will always be the case in the future. We could be adversely affected by any major hostilities, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. Furthermore, several countries restrict business with Israel and Israeli companies, and additional countries or companies may restrict doing business with Israel and Israeli companies as the result of the aforementioned hostilities. No predictions can be made as to whether or when a final resolution of the area’s problems will be achieved or the nature thereof and to what extent the situation will impact Israel’s economic development or our operations.

Some of our directors and officers as well as many of our Israeli employees are obligated to perform annual military reserve duty in Israel. We cannot assess the potential impact of these obligations on our business.

Some of our directors, officers and employees are, unless exempt, obligated to perform annual military reserve duty, depending upon their age and prior position in the army. They may also be further subject to being called to active duty at any time under emergency circumstances. Directors, officers, and key employees falling within these requirements include Roy Zisapel, our Chief Executive Officer and President, Amir Peles, our Chief Technical Officer, and Yuval Pemper, our Vice President, Research and Development. Our operations could be disrupted by the absence, for a significant period, of one of more of these officers or other key employees due to military service, and any disruption in our operations would harm our business. The full impact on our workforce or business if some of our officers and employees will be called upon to perform military service, especially in times of national emergency, is difficult to predict.

The rate of inflation in Israel and the change in the exchange rate between the New Israeli Shekel against the U.S. dollar and/or the U.S. dollar against the Euro is volatile, and may negatively impact our costs.

Most of our revenues are denominated in U.S. dollars or are dollar-linked, but we incur a portion of our expenses, principally salaries and related personnel expenses, in other currencies mainly in Israel, in New Israeli Shekels (“NIS”) and in Europe, in Euros. In 2006, we sold in Euros in most European countries. In this respect, we are exposed to the following risks: the rate of inflation in Israel may exceed the rate of devaluation of the NIS in relation to the dollar, the timing of this devaluation may lag behind inflation in Israel, or the NIS may increase in value relative to the dollar. In such events, the dollar cost of our operations in Israel will increase and our dollar-measured results of operations will be adversely affected. In addition, if the Euro increases in value relative to the dollar and sales in Euros do not exceed expenses incurred in Euros, the dollar cost of our operations in Europe will increase and our operating profit will be adversely affected. If the Euro decreases in value relative to the dollar and sales in Euros exceed expenses incurred in Euros, our operating profit will be negatively affected as a result of a decrease in the dollar value of our sales. In 2006, the value of the dollar decreased in relation to the NIS by 8.2%, the inflation rate in Israel was -0.1%, and the value of the dollar decreased in relation to the Euro by 10.2%. As a result, during 2006, we had an increase in expenses (as a result of the increase in the Euro exchange rate relative to the dollar), which was offset by the increase we had in our sales due to the fact that our sales to the EU countries are also denominated in Euro. We cannot provide assurances that we will not be materially adversely affected by the rate of inflation in Israel or exchange rate fluctuations in the future.

The tax benefits we may receive in connection with our approved enterprise program require us to satisfy prescribed conditions and may be terminated or reduced in the future. This would increase taxes and decrease our net profit

The Investment Center has granted us an approval to establish an “Approved Enterprise” program at our Tel Aviv and Jerusalem facilities. An Approved Enterprise is eligible for tax benefits on taxable income derived from its Approved Enterprise programs. The benefits available to an Approved Enterprise are dependent upon the fulfillment of conditions stipulated in applicable law and in the certificate of approval. If we fail to comply with these conditions, in whole or in part, with respect to any Approved Enterprise program we establish, or if we voluntarily decide to cease the Approved Enterprise program, we may be required to pay additional taxes for the period in which we benefited from the tax exemption or reduced tax rates and we would likely be denied these benefits in the future. One criterion for establishing the level of tax benefits is the percentage of holdings by foreign (i.e. non-Israeli) investors in our shares. A decrease in the level of foreign investors’ holdings may increase our tax rate.

An amendment to the Investment Law, which was published on April 1, 2005 (the “Amendment”) has changed certain provisions of the Investment Law. As a result of the Amendment, the Company is no longer obliged to obtain an Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, the Company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. The Company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment. Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (referred to as a “Benefited Enterprise” under the Amendment). In order to receive the tax benefits, the Amendment states that the Company must make an investment in the Benefited Enterprise exceeding a minimum amount specified in the Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the Company requested to have the tax benefits apply to the Benefited Enterprise (the “Year of Election”). Where the Company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the Company’s effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage of the Company’s production assets before the expansion.

Our approved program and tax benefits thereunder may not continue in the future at their current levels or at any level. The termination or reduction of these tax benefits would likely increase our taxes. The amount, if any, by which our taxes would increase will depend upon the rate of any tax increase, the amount of any tax benefit reduction, and the amount of any taxable income that we may earn in the future.

Provisions of Israeli law could delay, prevent, or make difficult, a change of control, thereby depressing the price of our ordinary shares.

Provisions of Israeli Corporate and tax law may have the effect of delaying, preventing or making an acquisition of our Company more difficult. For example, under the Companies Law, upon the request of a creditor of either party to a proposed merger, the court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. These provisions could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control over us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unwilling to do so because of these provisions of Israeli law. For additional information on this topic, see “Item 10B - Additional Information - Memorandum and Articles of Association - Mergers and Acquisitions under Israeli law.”

It may be difficult to enforce a U.S. judgment against us and/or our officers and directors, or to assert U.S. securities laws claims in Israel.

We are incorporated under the laws of the State of Israel. Service of process upon us, our Israeli subsidiaries and affiliates, and our directors and officers named herein substantially all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, because the majority of our assets and investments, and substantially all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or any of them may not be collectible within the United States.

It may be difficult to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing these matters.

Subject to specified time limitations and legal procedures, under the rules of private international law currently prevailing in Israel, Israeli courts may enforce a U.S. final judgment in a civil matter, including a judgment based upon the civil liability provisions of the U.S. securities laws and including a monetary or compensatory judgment in a non-civil matter, provided that:

- The judgment is enforceable in the state in which it was given;
- Adequate service of process has been effected and the defendant has had a reasonable opportunity to present his arguments and evidence;
- The judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;

- The judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties; and
- An action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the U.S. court.

ITEM 4. Information on the Company

History and Development of the Company

Radware Ltd. was organized in May 1996 as a corporation under the laws of the State of Israel, and commenced operations in April 1997. Our principal executive offices are located at 22 Raoul Wallenberg Street, Tel-Aviv 69710, Israel and our telephone number is 972-3-766-8666. Our website address is www.radware.com. *Information contained on our website does not constitute a part of this annual report.*

As of January 1, 1999, we established a wholly-owned subsidiary in the United States, Radware Inc., which conducts the sales and marketing of our products in the Americas and is our authorized representative and agent in the United States. The principal offices of Radware Inc. are located at 575 Corporate Dr., Lobby 2, Mahwah, NJ 07430 and its telephone number is 201-512-9771.

We also have several wholly owned subsidiaries world-wide handling local support and promotion activities.

For a discussion of our capital expenditures and divestitures, see “Item 5—Operating and Financial Review and Prospects - Liquidity and Capital Resources.”

Business Overview

General

We develop, manufacture and market Application Delivery and Network Security (“business-smart networking”) solutions that provide end-to-end availability, performance and security of mission critical networked applications. Radware’s integrated Application Front-End, Application Access and Network Security solutions enable enterprises and carriers to deliver their mission critical applications successfully between data centers and remote locations, over all critical points in the network.

Our Application Delivery and Network Security solutions enable customers to manage their network infrastructure, bypass systems failures, scale their application performance, and secure their Internet protocol (“IP”) traffic. Our products align network behavior with business process to improve productivity and extract the greatest value from investments in network infrastructures by intelligently distributing traffic within the network, optimizing the use of available network resources and protecting applications, networks and users at high speeds. Over the years, our products have won a number of awards for performance, including Network Computing Editor’s Choice, SC Magazine Recommended Buy Award, Network Computing Well-Connected, Internet World Best of Show, PC Magazine Editor’s Choice and Network Magazine Product of the Year. All of our products are Underwriters Laboratories (UL) compliant and our products have also achieved significant industry certification such as the Common Criteria Evaluation & Validation Scheme (CCEVS) EAL 3 through the National Security Agency (NSA) program and FIPS 140-2 through the National Institute of Standards (NIST). In addition, we have been recognized as among the top industry players in our respective markets by independent, third-party IT analysts - for example, Forrester Research, Frost & Sullivan, Gartner, IDC, and Yankee Group.

In April 2007, we acquired Covelight, a U.S. based company, which provides web channel intelligence technology that allows business events to be captured in real-time on the network. This strategic move is intended to increase the market relevance of our APSolute product portfolio by moving from the "application-smart" approach to a new, more business-centric approach, which we position as "business-smart networking".

Products, Operating System (OS), Management Tool, Platforms, and Subscription Services

Radware sells application delivery and network security products (“devices”) that run different configurations of software to deliver features specific to the intended operation of the appliance. These products utilize the proprietary APSolute OS (operating system), which embeds common operating logic into each product. Multiple Radware devices can be managed through the APSolute OS common management tool and dashboard (Insite) and are delivered via hardware switching platforms (AS1 - AS5) with various levels of processing power, throughput, port density, and speed depending on selected model. In addition, Radware offers a security update subscription service. Its products, operating system, management tools, switching platforms, and subscription services are all marketed under the APSolute brand.

Products (APSolute Product Suite)

The APSolute™ product suite consists of the following product families:

- *AppDirector™ Intelligent Application Delivery Controller* for data center optimization with advanced Layer 4-7 policies and granular packet classification to eliminate traffic surges, server bottlenecks, connectivity disconnects and downtime for ensured business continuity.
- *AppXcel™ Application Accelerator* performs web compression and Hypertext Transfer Protocol (HTTP) multiplexing, and accelerates web applications for high performance content serving and Secure Sockets Layer (“SSL”) encryption and decryption, providing secure and effective SSL processing.
- *LinkProof®* manages Internet traffic for networks, commonly referred to as multi-homed networks, which access the Internet through multiple connections via several Internet Service Providers, to provide fault tolerant and cost effective Internet connectivity.
- *LinkProof® Branch* manages the operation of multiple links across all remote office links, allowing large, multi-branched enterprises to control and reduce the costs of their connectivity and Virtual Private Networks (VPN) between headquarters and branch offices.
- *DefensePro®* Intrusion Prevention and Denial of Service products protect against worms, bots, viruses, malicious intrusions and Denial of Service attacks at up to 6-Gigabit speeds, preventing attacks in real-time for intrusion prevention and multi-layer application defense.
- *SecureFlow™* simplifies the management and optimizes performance of best of breed enterprise security tools to enable transparent, selective integration of content inspection, anti-virus, VPN, Intrusion Detection Systems (IDS) and firewalls into a unified switched architecture to eliminate the security/performance tradeoff.
- *Inflight™* delivers real-time business events to backend analytic engines (e.g. enterprise fraud, compliance, business intelligence, marketing, etc.) by performing passive identity-based monitoring of critical web channel application transaction activity. With Inflight, companies can optimize their business processes, offer new products and services on-the-fly to customers, and halt identity theft or fraudulent online behavior
- *CID - Content Inspection Director®* managed service delivery platform for carriers that enables centralized and optimized IP value added service deployment. With Content Inspection Director, carriers can extend high-performance security and media services to customers, customizing delivery, guaranteeing SLAs and generating a new source of revenues.

Operating System (APSolute OS)

APSolute OS is a modular operating system built around Radware’s core software engines, the Application Classifier and Flow Manager that are used to classify traffic based on an extensive and granular set of application intelligence. Users can define classes of traffic and policies for how network resources should handle that traffic based on any combination of network, application, content and user information. APSolute OS service modules (each as described below), which are available on our hardware products, include: Advanced Health Monitoring, Traffic Redirection, Bandwidth Management, Application Acceleration, Intrusion Prevention and DoS Protection. With APSolute OS, enterprises and carriers can address existing and emergent application service requirements across server farms, security and connectivity layers.

- *APSolute OS Application-Smart Classification and Flow Management*

Radware’s innovative APSolute OS features a unique classification and flow management engine that is used to classify traffic based on the industry’s most extensive and granular set of application intelligence. Users can define classes of traffic and policies for how network resources should handle that traffic based on any combination of network, application, content and user information. APSolute OS tracks the flow of traffic end-to-end and implements multi-step decisions at every critical point across the transaction path to ensure optimized application delivery.

- *APSolute OS Health Monitoring and Failure Bypassing*

APSolute OS Health Monitoring continuously checks all network resources detecting failures in real-time and automatically redirecting traffic to the highest performing resources to bypass failures and guarantee high application availability and continuous operations.

- *APSolute OS Traffic Redirection*

APSolute OS Traffic Redirection intelligently distributes traffic across network devices to optimize the utilization of local and global resources, and ensure service availability and redundancy. APSolute OS Traffic Redirection enables maximum utilization of IT infrastructure capacities across farms, local and global sites using an extensive array of traffic redirection algorithms to dispatch traffic including cyclic distribution, least users, least packets and least bytes.

- *APSolute OS Bandwidth Management*

APSolute OS Bandwidth Management extends granular classification and control over bandwidth resource allocation, prioritizing all network traffic and guaranteeing service levels for mission critical applications across the entire network (with TOS and Diffserv marking).

- *APSolute OS Application Acceleration*

The APSolute OS advanced Layer 4-7 application acceleration technologies include: SSL offloading, Transmission Control Protocol (TCP) optimization, caching and reverse proxy, HTTP compression and advanced image and content compression.

- *APSolute OS Intrusion Prevention*

Automatically secures application network resources by continuously monitoring and inspecting all network traffic including SSL traffic, APSolute OS Intrusion Prevention immediately terminates suspicious sessions by implementing user/application/ content policies to completely safeguard applications. On-the-fly SSL inspection and IP reassembly provide an additional layer of protection against hacker evasion techniques.

- *APSolute OS DoS Protection*

Identifies and stops debilitating Denial of Service (DoS), Distributed Denial of Service (DDoS), and Structured Query Language (SQL) injections and protocol/traffic anomalies, protecting the network from service failures and downtime. Using advanced technologies including behavior-based analysis, APSolute OS DoS Protection automatically detects abnormal requests and thwarts network attacks before they undermine server operations, all the while ensuring secure traffic operations for uninterrupted service continuity.

Management Tool (APSolute Insite)

The common application management tool which runs across all Radware products is APSolute Insite. APSolute Insite is a unified management tool with an intuitive Graphical User Interface (GUI) that provides end-to-end network visibility, control and policy management of all application switching devices.

Based on an easy-to-use site map interface, APSolute Insite lets users draw their network, configure Radware Application-smart switching devices and set-up the APSolute OS Services (as described above) to address end-to-end IP application service requirements. APSolute Insite's statistics module provides real-time and historical views of actual application performance levels for monitoring site-wide operations and simple pinpointing of vulnerabilities and failures, affording complete visibility and control over the performance of Web and Application Servers, security tools, cache servers, anti-virus tools and Internet links. Based on this information, network administrators can decide to add resource capacities, tune bandwidth policies or relocate devices to better manage actual traffic loads and IP application performance requirements. Insite is also offered as a standalone network device under the Insite ManagePro label.

Application Switch Platforms

All Radware products are powered by our Application Switch platforms. Radware purpose-built Application Switching hardware offers scalable and flexible throughput performance to meet the broad range of enterprise and carrier end-to-end application delivery requirements.

Radware's Application Switch 1 combines ASIC-based switching, CPU processing power and APSolute OS Services to deliver the performance and service breadth to address all IP application requirements across network layers 4-7. Designed to guarantee application availability, security and performance, Application Switch 1 bridges the gap between IT infrastructure and IP Applications for comprehensive control of all critical operations across the enterprise.

Application Switch 2 is powered by a multi-layered switching architecture designed to address the widest set of protocols and service requirements across network layers 4-7 while boosting IP application performance to Gigabit Speeds. Delivering accelerated processing speeds with the ability to optimize routing decisions based on specific applications, web requests and content, Application Switch 2 provides reliability, performance and security across IP applications, for complete control over enterprise operations.

Application Switch 3 is a 3-tier processing architecture designed to meet the high capacity processing requirements for the most intensive layer 4-7 switching operations. Dual network processors in the second tier of the Application Switch 3 architecture, accelerate traffic redirection, load-balancing, quality of service control, real-time intrusion prevention and DoS mitigation for application security to multi-Gigabit speeds. The third-tier in the Application Switch 3 architecture is the powerful RISC processor that is responsible for managing and prioritizing all active application sessions.

Application Switch 4 is a three-tier processing architecture designed to meet the high capacity processing requirements for the most intensive intelligent application switching operations. Application Switch 4 features 44Gb connectivity, multi-Gigabit network processors and a strong 1.3-GHZ CPU. Driving application switching performance to up to 3-Gigabit speeds, AS4 affords complete control over mission critical applications and explosive transactions across the most demanding networking environments.

In 2006, we introduced our latest high-end platform for large enterprises and carriers, Application Switch 5, which doubles the throughput capacity of Application Switch 4 released in 2005. Application Switch 5 features an 88Gb switching backbone, multi-Gigabit network processors, strong 1.7-GHZ CPU and a dual power supplies to provide the industry's fastest Layer 7 performance and highest port density. We are also offering a new switch for our entry-level DefensePro® IPS/DoS x02 model series, the Security Platform 1.

Our products are compatible with any system that uses the Internet protocol and can operate with various network structures, configurations and operating systems. Our products support a wide variety of IP-based applications, including web services, e-mail, voice, P2P, Enterprise Resource Planning (ERP), Customer Relationship Management tools, database and file transfers.

Security Update Service

The Security Update Service, available as an optional subscription service, consists of Periodic Updates, Emergency Updates, and Custom Filters, which are supported by a Security Operations Center (Vulnerability & Exploit Detection; Security Risk Assessment, and Threat Mitigation). The service provides immediate and ongoing security updates to protect customers against the latest threats.

Customers and End-Users

With the exception of our limited direct sales efforts to select customers, we sell our products through distributors or resellers who then sell our products to end users.

We have a globally diversified end-user base, consisting of corporate enterprises including banks, insurance companies, manufacturing and retail, government agencies, media companies and service providers, such as telecommunication carriers, Internet service providers and application service providers. Customers in these different vertical markets deploy Radware for availability, performance and security of their applications from headquarters to branch offices.

In 2006, approximately 34% of our sales were in the Americas (principally in the United States), 34% were in EMEA (Europe, Middle East and Africa) and 32% in Asia-Pacific. Other than the United States, no single country accounted for more than 10% of our sales for 2006.

For the years ended December 31, 2006, 2005 and 2004, one single customer (a distributor) accounted for 12%, 16% and 11% of our sales, respectively. As of December 31, 2006 and 2005, no single customer represented more than 10% of the trade receivables balance.

Sales and Marketing

Sales. We market and sell our products primarily through an indirect sales channel that consists of distributors and resellers located in North America, Europe and Asia. In addition, we generate direct sales to select customers. Our sales channels are supported by our sales managers who are also responsible for recruiting potential distributors and resellers and for initiating and managing marketing projects in their assigned regions. The sales managers are supported by our internal sales support staff that help generate and qualify leads for the sales managers. As of December 31, 2006, we employed a total of 38 sales managers and sales staff in the Americas with locations in various states. We also employed 70 sales managers and sales staff based in the rest of the world, who are responsible for developing and maintaining distribution channels outside the Americas. We have subsidiaries and representative offices and branches in several countries, which promote and market our products and provide customer support in their respective regions.

Marketing Strategy. Our marketing strategy is to enhance brand recognition and maintain our reputation as a provider of technologically advanced, quality Application Delivery and Network Security solutions. We seek to build upon our marketing and branding efforts globally to achieve greater worldwide sales. Our sales force and marketing efforts are principally directed at developing brand awareness and providing sales support to our distributors. We participate in major trade shows and offer support to our distributors who participate in regional trade shows and events. We also invest in web based and print advertising campaigns as well as a global media and public relations campaign. In addition to our independent marketing efforts, we invest in joint marketing efforts with our distributors, value added resellers and other companies that have formed strategic alliances with us.

We have entered into co-marketing arrangements with companies in other complementary segments, including:

- Aladdin Knowledge Systems Ltd.;
- Avaya, Inc.;
- Aventail Corporation;

- BEA Systems, Inc.;
- BMC Software Inc.;
- CA, Inc.;
- Finjan Software;
- Hewlett Packard Company;
- IBM, Inc.;
- Microsoft Corporation;
- Oracle Corporation; and
- SAP AG.

Strategic Alliances and Original Equipment Manufacturer Agreements. We have entered into strategic alliances and original equipment manufacturer agreements with other software and hardware vendors, including Forum Systems, Inc. and Imperva, Inc. as well as mutual channel information sharing arrangements. We believe that these companies have significant customer relationships and offer products which complement our products. The products are branded with the names of these companies or co-branded with our name. These agreements are standard distributor agreements, purchase agreements, OEM (original equipment manufacturer) agreements or other specific agreements and are terminable by either party at will. We plan to further invest in the development of strategic alliances in order to provide greater access to our target markets and enhance our brand name.

Technical Management

Our technical team, which consists of 110 employees worldwide as of December 31, 2006, supports our sales force during the sales process, assists our customers and distributors with the initial installation, set-up and ongoing support of our products, trains distributors and customers to use our products and provides software updates and product upgrades for our products. In addition, our technical team trains and certifies our distributors to provide limited technical support in each of the geographical areas in which our products are sold, and is directly responsible for remote support. Our Certainty Support Program provides offerings which allow customers to automatically get new software versions of their products and obtain optimized performance by purchasing any of the following five optional offerings: extended warranty, software updates, 24x7 help-desk (directly to our customers and through our distributors), on-site support and unit replacement.

Research and Development

In order to maintain our share of the Application Switching market, we place considerable emphasis on research and development to expand the capabilities of our existing products, develop new products and improve our existing technologies and capabilities. We believe that our future success will depend upon our ability to maintain our technological expertise, enhance our existing products and introduce, on a timely basis, new commercially viable products that will continue to address the needs of our customers. Accordingly, we intend to continue devoting a significant portion of our personnel and financial resources to research and development. In order to identify market needs and to define appropriate product specifications, as part of the product development process we seek to maintain close relationships with current and potential distributors, customers and vendors in related industry segments.

As of December 31, 2006, our research and development staff consisted of 163 employees. Research and development activities take place at our facilities in Israel. We employ established procedures for the requirement management, development and quality assurance of our new product developments. Our research and development organization is divided according to our existing products. Each product group is headed by a group leader and includes team leaders and engineers. In addition, we have a hardware and platform software department responsible for the development of the Radware hardware platforms and platform software, which are the basis for all products, serving all product groups, which consists of a senior group leader, group leaders, team leaders, and engineers. We also have an application infrastructure software group responsible for the software which is common to all our products (such as the management tools), which consists of a group leader, team leaders and engineers. We furthermore have a quality assurance department, which assists all product groups, and includes a QA director, group leaders, team leaders and quality control engineers and technicians.

We occasionally use third-party subcontractors for the development of portions of research and development projects.

Manufacturing and Suppliers

USR Technologies and Electronics (2003) Ltd. (“USR”) manufactures most of the circuit boards which are the principal hardware component used in our products. It supplies us with finished circuit boards for final assembly. The other components and subassemblies included in our products are supplied to USR from a limited group of suppliers and subcontractors. USR monitors each stage of the circuit board production process, including the selection of components and subassembly suppliers. USR is ISO 9002 certified, indicating that its manufacturing processes adhere to established quality standards.

We install our proprietary software onto the circuit boards we receive from USR. Quality assurance testing, final assembly and packaging and shipping operations are primarily performed at our facility in Jerusalem, Israel.

These circuit boards are the principal component which we use in the manufacture of our products. If we are unable to acquire circuit boards from USR on acceptable terms, or should USR cease to supply us with circuit boards for any reason, we may not be able to identify and integrate an alternative source of supply in a timely fashion or at the same costs. Any transition to one or more alternate suppliers would likely result in delays, operational problems and increased costs, and may limit our ability to deliver our products to our customers on time for such transition period. We entered into agreements with two additional suppliers, but to date have only purchased relatively small quantities from those suppliers. If we would need to rely on the alternate suppliers, there is no assurance that we will be able to obtain the quantities we require at lead times and pricing competitive to USR.

Our activities in Europe require that we comply with European Union Directives with respect to product quality assurance standards and environmental standards.

Proprietary Rights

We rely on patent, trademark and trade secret laws, as well as confidentiality agreements and other contractual arrangements with our employees, distributors and others to protect our technology. We have a policy that requires our employees to execute employment agreements, including confidentiality and non-compete provisions.

We have registered trademarks for “Web Server Director®,” “Cache Server Director®”, “FireProof®”, “LinkProof®”, “Triangulation®”, “Smart Nat®”, “Get Certain®”, “CertainT®”, “Peer Director®”, “Synapps Architecture®”, “DefensePro®”, “StringMatch Engine®” and “CID - Content Inspection Director®” and we have trademark applications pending for “UpLink™”, “Radware™”, “APSolute™”, “AppDirector”™, “AppXCel”™ , “SecureFlow”™, “SOADirector”™, “SOASwitch”™, “SIPDirector”™ and “DFI- Deep Flow Inspection”™. We do not currently own any registered copyrights. We have registered patents in the United States for our triangle redirection method used for the global load balancing, for our mechanism for efficient management and optimization of multiple links used in our LinkProof product, for our method for load balancing by global proximity used in our WSD product and for our method for controlling traffic on links between autonomous BGP systems. We have pending patent applications and provisional patents in connection with several methods and features used in our products. These applications may not result in any patent being issued, and, if issued, the patents may not provide adequate protection against competitive technology and may not be held valid and enforceable if challenged. In addition, other parties may assert rights as inventors of the underlying technologies, which could limit our ability to fully exploit the rights conferred by any patent that we receive. Our competitors may be able to design around any patent we receive and other parties may obtain patents that we would need to license or circumvent in order to exploit our patents.

The protective steps we have taken may be inadequate to deter misappropriation of our technology and information. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights. Some of the countries in which we sell our products do not protect intellectual property to the same extent as the United States and Israel. In addition, our competitors may independently develop technologies that are substantially equivalent or superior to our technology. Any licenses for intellectual property that might be required for our services or products may not be available on reasonable terms.

Competition

The Application Delivery and Network Security markets are highly competitive and we expect competition to intensify in the future. We may lose market share if we are unable to compete effectively with our competitors. Our principal competitors in the Application Delivery solutions market include: F5 Networks, Inc., Cisco Systems, Inc., Citrix Systems, Inc. Foundry Networks, Inc., and Juniper Networks, Inc. In addition, we face competitors in the Network Security space, with respect to our Intrusion Prevention Systems (IPS). Such principal competitors include Juniper Networks, Inc., 3Com Systems, Inc. (TippingPoint), McAfee, Inc., Sourcefire, Inc., and IBM Corporation (Internet Security Systems), We expect to continue to face additional competition as new participants enter the market. Larger companies with substantial resources, brand recognition and sales channels may form alliances with or acquire competing Application Delivery or Network Security solutions and emerge as significant competitors. For example, IBM Corporation became a competitor in the Network Security market by acquiring Internet Security Systems (ISS). Competition may result in lower prices or reduced demand for our products and a corresponding reduction in our ability to recover our costs, which may impair our ability to maintain and increase profitability. Furthermore, the dynamic market environment, which is demonstrated by the above acquisitions, poses a challenge in predicting market trends and expected growth.

We believe that our success will depend primarily on our ability to provide more technologically advanced and cost-effective Application Delivery and Network Security solutions, and more responsive customer service and support, than our competitors. However, we cannot assure you that the products we offer will compete successfully with those of our competitors. Furthermore, should competition intensify, we may have to reduce the prices of our products which will negatively impact our business and financial condition.

Israeli Office of Chief Scientist

From time to time, eligible participants may receive grants under programs of the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the Chief Scientist. Grants received are generally repaid through a mandatory royalty based on revenues from the sale of products (and ancillary services) incorporating know-how developed, in whole or in part, with the grants. This governmental support is conditioned upon the participant’s ability to comply with certain applicable requirements and conditions specified in the Chief Scientist’s program and with the provisions of the Law for the Encouragement of Research and Development in the Industry, 1984, and the regulations promulgated thereunder, or the Research and Development Law. Under the Research and Development Law, research and development programs that meet specified criteria and are approved by the Research Committee of the Chief Scientist are eligible for grants usually of up to 50% of certain approved expenditures of such programs, as determined by said committee. In exchange, the recipient of such grants is required to pay the Chief Scientist royalties from the revenues derived from products incorporating know-how developed within the framework of each such program or derived therefrom (including ancillary services in connection therewith), up to an aggregate of 100% of the dollar-linked value of the total grants received in respect of such program, plus interest.

The Israeli government is currently in the process of formulating a proposed amendment to the royalty regulations promulgated under the Research and Development Law. The amendment is expected to include changes to the royalty rates, which would vary from company to company based on the amount of its revenues and approval date of its program, up to a rate of 6%, and, as of 2006, to increase the rate of interest accruing on grants by 1% per year. The amendment was expected to have retroactive effect from January 1, 2006, although there is no assurance as to whether and when it will be adopted. The Research and Development Law generally requires that the product developed under a program be manufactured in Israel. However, upon notification to the Chief Scientist, up to 10% of the manufacturing volume may be performed outside of Israel; furthermore, upon the approval of the Chief Scientist, a greater portion of the manufacturing volume may be performed outside of Israel, provided that the grant recipient pays royalties at an increased rate, which may be substantial, and the aggregate repayment amount is increased up to 300% of the grant, depending on the portion of the total manufacturing volume that is performed outside of Israel. The Research and Development Law further permits the Chief Scientist, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of the increased royalties. The Research and Development Law also allows for the approval of grants in cases in which the applicant declares that part of the manufacturing will be performed outside of Israel or by non-Israeli residents and the Research Committee is convinced that doing so is essential for the execution of the program. This declaration will be a significant factor in the determination of the Chief Scientist whether to approve a program and the amount and other terms of benefits to be granted. For example, the increased royalty rate and repayment amount will be required in such cases.

By December 31, 2001, we repaid by way of royalties the full amount we owed to the Chief Scientist. In 2004, we applied, together with another company, to obtain a grant from the Chief Scientist under the “joint R&D project” track. The Chief Scientist approved the maximum grant to the project of approximately \$0.2 million. In 2005, we applied to obtain an additional grant from the Chief Scientist, under the same project. The Chief Scientist approved an additional grant to the project in an additional maximum amount of approximately \$0.2 million. During 2005 and 2006 we have received an aggregate amount of \$0.4 million for this project from the Chief Scientist.

The Research and Development Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the approval of the Research Committee. Such approval is not required for the export of any products resulting from such research or development. The Research and Development Law further provides that the know-how developed under an approved research and development program may not be transferred to third parties outside Israel, except in certain circumstances and subject to the Chief Scientist’s prior approval. The Chief Scientist may approve the transfer of Chief Scientist-funded know-how outside Israel, generally in the following cases: (a) the grant recipient pays to the Chief Scientist a portion of the sale price paid in consideration for such Chief Scientist-funded know-how (according to certain formulas), or (b) the grant recipient receives know-how from a third party in exchange for its Chief Scientist-funded know-how, or (c) such transfer of Chief Scientist-funded know-how arises in connection with certain types of cooperation in research and development activities.

The Research and Development Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and foreign interested parties to notify the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Chief Scientist to comply with the Research and Development Law. In addition, the rules of the Chief Scientist may require additional information or representations in respect of certain of such events. For this purpose, “control” is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. “Means of control” refers to voting rights or the right to appoint directors or the chief executive officer. An “interested party” of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 5% or more of our ordinary shares will be required to notify the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research and Development Law.

The Israeli authorities have indicated in the past that the government may further reduce or abolish the Chief Scientist grants in the future. Even if these grants are maintained, we cannot presently predict what would be the amounts of future grants, if any, that we might receive.

Organizational Structure

As of January 1, 1999, we established a wholly-owned subsidiary in the United States, Radware Inc., which conducts the sales and marketing of our products in America. We also have subsidiaries in Australia, France, Germany, the United Kingdom, Italy, Japan, Singapore, Korea, Canada, Switzerland and India. We have also established representative offices in China, Taiwan and Russia. All of our subsidiaries are wholly-owned. All our subsidiaries and branches promote and offer support for our products. In April 2007 we purchased Covelight Systems, Inc., a Delaware corporation, which develops and manufactures the APSolute Inflight product. Our subsidiaries include:

| Name of Subsidiary | Country of Incorporation |
|-----------------------------|--------------------------------------|
| Radware Inc. | New Jersey, United States of America |
| Radware UK Limited | United Kingdom |
| Radware France | France |
| Radware Srl | Italy |
| Radware GmbH | Germany |
| Nihon Radware KK | Japan |
| Radware Australia Pty. Ltd. | Australia |
| Radware Singapore Pte. Ltd. | Singapore |
| Radware Korea Ltd. | Korea |
| Radware Canada Inc. | Canada |
| Radware GmbH | Switzerland |
| Radware India Pvt. Ltd. | India |
| Covelight Systems, Inc.(*) | Delaware, United States of America |

(*) Purchased during 2007

Yehuda Zisapel is a co-founder and shareholder of Radware. Yehuda Zisapel is also a member of the Board of Directors of Radware. Individually or together with his brother, Zohar Zisapel, he is also a founder, director and/or principal shareholder of several other companies which, together with Radware and our subsidiaries listed above are known as the RAD-Bynet Group. These corporations include:

| | | |
|---------------------------------|---|-----------------------|
| AB-NET Communications Ltd. | Ceragon Networks Ltd. | WISAIR Inc. |
| BYNET Data Communications Ltd. | Commex Technologies Ltd. | Sanrad Inc. |
| BYNET Electronics Ltd. | Packetlight Networks Ltd. | RADLive Ltd. |
| BYNET SEMECH (outsourcing) Ltd. | RAD-Bynet Properties and Services (1981) Ltd. | RADView Software Ltd. |
| Bynet Software Systems Ltd. | RADCOM Ltd. | RADVision Ltd. |
| Bynet System Applications Ltd. | RAD Data Communications Ltd. | RADWIN Ltd. |
| | | RiT Technologies Ltd. |
| | | Silicom Ltd. |

The group also includes several other holdings, real estate companies, biotech and pharmaceutical companies. The above list does not constitute a complete list of the investments of Messrs. Yehuda and Zohar Zisapel.

In addition to engaging in other businesses, members of the RAD-Bynet Group are actively engaged in designing, manufacturing, marketing and supporting data communications products, none of which currently compete with our products. Some of the products of members of the RAD-Bynet Group are complementary to, and may be used in connection with, our products. See also “Item 7 - Major Shareholders and Related Party Transactions - Related Party Transactions”.

Property, Plants and Equipment

Israel. Our headquarters and principal administrative, finance, research and development and marketing operations are located in approximately 48,420 square feet of leased office space in Tel Aviv, Israel. The lease expires in October 2007. The facilities are leased from affiliated companies owned by Messrs. Yehuda and Zohar Zisapel. For more information see - “Item 7 -Major Shareholders and Related Parties Transactions.” We also lease office space in a nearby location in Israel, of which approximately 2,590 square feet are leased from the same related party and approximately 5,920 square feet are leased from an unaffiliated party.

We also sublease approximately 5,482 square feet of space in Jerusalem for our manufacturing facility from USR. The sublease with respect to 2,150 square feet expires in April 2009 and the sublease with respect to the remaining 3,332 square feet expires in December 2007.

The aggregate annual rent for the premises in Israel for 2006 was approximately \$686,000.

Other locations. In the United States, we lease approximately 12,382 square feet in Mahwah, New Jersey from a company owned by Yehuda and Zohar Zisapel, which lease will expire in April 2010. We also lease 4,916 square feet from an unaffiliated party in Costa Mesa, California, which lease expired in March 2007 and is renewable on a month to month basis. We also lease 3,024 square feet in Dallas, Texas from an unaffiliated party, which lease expires in February 2009. In addition, we lease facilities for the operation of our subsidiaries and representative offices in several locations in the United States, Europe and Asia Pacific.

The aggregate annual rent for the premises in locations outside Israel in 2006 was approximately \$1,262,000.

Outlook. We may need additional space if we expand our business. In the event that additional or substitute offices and facilities are required, we believe that we could obtain such offices and facilities at commercially reasonable rates.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

General

Our discussion and analysis of our financial condition and results of operation are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. Our operating and financial review and prospects should be read in conjunction with our financial statements, accompanying notes thereto and other financial information appearing elsewhere in this annual report.

We are a provider of integrated application delivery and network security solutions, assuring availability, performance and security of business critical networked applications. We began selling our products in 1997, and currently have local offices, subsidiaries or branches in 15 countries in Asia-Pacific, Europe and the Americas.

We sell mainly through sales channels such as resellers and distributors. Most of our direct sales are to strategic customers in the United States. The web channel intelligence technology acquired from Covelight Systems in April 2007 (“Inflight”) will be sold under the existing APSolute product portfolio through primarily direct sales channels in the first phase and through resellers and distributors in subsequent phases.

Most of our revenues are generated in U.S. dollars or are dollar-linked and the majority of our expenses are incurred in dollars and, as such, we use the dollar as our functional currency. Our consolidated financial statements are prepared in dollars and in accordance with U.S. GAAP.

Revenues. Our revenues are derived primarily from sales of our products and, to a lesser extent, from sales of post-contract customer support through our Certainty Support program and sales of a security subscription service the “Security Update Service” (“SUS”). We generally recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, no further obligation exists and collectability is probable. Post-contract customer support and the SUS service, which represents mainly software update subscriptions, help-desk support and unit repairs or replacements, is recognized ratably over the contract period.

Cost of Sales. Cost of sales refers to both products and service revenues and consists primarily of the cost of circuit boards and other components required for the assembly of our products, salaries and related personnel expenses for those engaged in the final assembly and maintenance service of our products and other overhead costs. Most of our Cost of Sales expenses are not fixed costs and are directly related to our revenues.

Research and Development Expenses. Research and development (“R&D”) expenses consist primarily of salaries and related personnel expenses, costs of subcontractors and prototype expenses related to the design, development, quality assurance and enhancement of our products, and depreciation of equipment purchased for the development and testing processes. All research and development costs are expensed as incurred. We believe that continued investment in research and development is critical to attaining our strategic product objectives and therefore we plan to invest additional resources in 2007 in expanding our R&D organization, including new hires and purchase of new and advanced testing and development equipment.

Marketing and Selling Expenses. Marketing and selling expenses consist primarily of salaries, commissions and related personnel expenses for those engaged in the sales and marketing of our products as well as the cost of operating the offices which are located outside Israel and are engaged in the promotion, marketing and support of our products, in addition to the related trade shows, advertising, promotions, web site maintenance and public relations expenses.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related personnel expenses for executive, accounting and administrative personnel, professional fees (which include legal, audit, expenses related to the implementation of Section 404 of the Sarbanes-Oxley Act, and additional consulting fees), bad debt expenses and other general corporate expenses.

Amortization of stock-based compensation. Our expenses also included amortization of stock-based compensation, which is allocated among cost of sales, research and development expenses, marketing and selling expenses and general and administrative expenses, based on the division in which the recipient of the option grant is employed. The stock-based compensation is being amortized to operating expenses over the vesting period of the individual options.

On December 16, 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “Share-Based Payment” (“SFAS No. 123(R)”), which is a revision of SFAS No. 123. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values while SFAS No. 123(R) requires all share-based payments to employees to be recognized, as of the first quarter of 2006, based on their fair values. SFAS No. 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods: (i) a “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date; (ii) a “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We adopted the new statement effective January 1, 2006, using the “modified prospective” method. The adoption of SFAS No. 123(R) in 2006 resulted in operating expenses of \$4.5 million and 24 cents loss per diluted share. The impact of SFAS 123(R) on our results of operations in future period may be affected by our stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price, expected forfeiture rate and employee stock option exercise patterns.

Financial Income (Expenses), Net. Financial income, net consists primarily of interest earned on short-term and long-term bank deposits, and of amortization of premiums, accretion of discounts and interest earned on investment in marketable securities of proceeds from the issuance of our shares to the public, from the exercise of options to purchase our shares, from cash generated from our operations and from income and expenses from the translation of monetary balance sheet items denominated in non-dollar currencies

Taxes. Israeli companies are generally subject to corporate tax on their taxable income at the rate of 31% for the 2006 tax year. Following an amendment to the Israeli Income Tax Ordinance [New Version], 1961 (the “Tax Ordinance”), which came into effect on January 1, 2006, the corporate tax rate is scheduled to decrease as follows: 29% for the 2007 tax year, 27% for the 2008 tax year, 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter. Israeli companies are generally subject to capital gains tax at a rate of 25% for capital gains (other than gains deriving from the sale of listed securities) derived after January 1, 2003. However, we have established an approved enterprise program (the “Program”), which is eligible for the tax benefits for operational profit, described below under the heading “Corporate Tax Rate”. These benefits result in part of our income being tax exempt or taxed at a lower rate for some time after we begin to report taxable income. The tax rate depends upon the percentage of our income derived at that time from the Approved Enterprise program. The tax benefits depend on our meeting the requirements of the Program and there is no assurance we will be able to obtain such benefits. We have carry-forward capital losses for tax purposes and we anticipate to utilize these losses in 2007 and subsequent years. We have recorded a deferred tax asset in relation to these losses. Our U.S. subsidiary and two other subsidiaries have carry-forward tax losses to offset against future taxable profit. We have recorded a deferred tax asset in relation to these carry-forward tax losses and we anticipate that we will utilize part of these tax losses in 2007 and after. We have also recorded a valuation allowance in connection with these deferred tax assets. Other subsidiaries of ours are taxed according to the laws in their countries of incorporation and tax expenses are recorded accordingly. We may incur, for accounting purposes, tax expenses in 2007 which we anticipate to be at a rate of up to 10% of our operating income.

Market Trends. According to IT analyst estimations, the IT market in 2006 continued to grow slightly but at a lesser rate than 2005. In terms of geographical variances, the U.S. experienced less overall IT spending growth than Western Europe and Asia Pacific, with China and India reaching double-digit growth percentage levels. While networking equipment drove growth in IT spending in 2005, it reached mature market conditions in 2006 and therefore had a slower share of contribution to overall IT spending than in previous years. Due to the slowing rate of growth in the market it is difficult to predict the conditions of our market going forward. In addition, we believe that market conditions cause our customers and potential customers to be more conservative in planning their spending. If the global conditions deteriorate, and companies in our target markets continue to reduce capital expenditures, we may experience a reduction in sales, as well as downward pressure on the price of our products. In addition, if the market continues to be flat and customers continue to experience low visibility we may not be able to increase our sales. Each of the above scenarios would have a material adverse effect on our business, operating results and financial condition.

Furthermore, at the end of 2005 and throughout the course of 2006 several acquisitions took place in our space which resulted in continuous changes in the competitive landscape. F5 acquired Swan Labs in the third quarter of 2005 for WAN optimization capabilities. Citrix continued its acquisition pattern in 2006 following its NetScaler (application acceleration) and Terros (application firewall) acquisitions in 2005, by acquiring Reflectent Software (application performance monitoring) and Orbital Data (WAN Optimization). And, IBM became a competitor in the Intrusion Prevention space by acquiring Internet Security Systems (ISS) in August of 2006. The dynamic market environment, which is demonstrated by the above acquisitions, poses a challenge in predicting market trends and expected growth.

We intend to continue our investment in the marketing and branding of our APSolute product family, in order to broaden market acceptance of such products. Such investment includes recruitment of skilled personnel, participation in trade shows, testing of our products by leading firms in the industry, investment in brand awareness and online advertising, and so forth. There is no assurance that we will be successful in such marketing and selling activities and that the increase in revenues, if any, will justify the investment.

Business Combinations. In December 2005, we acquired the business of V-Secure which included the acquisition of intellectual property, technology, customers relationship and goodwill. The initial consideration for the acquisition was \$9,168,000, out of which an amount of \$ 9,011,000 was paid in cash; and \$148,000 was paid by issuance of fully vested warrants to V-Secure to purchase 45,454 ordinary shares of the Company. The remaining balance was related to acquisition costs payable. Additional cash consideration of \$3,000,000 was paid as part of the purchase agreement during 2006 and V-Secure waived any claim or demand for additional payments. Accordingly, the total consideration for the acquisition amounted to \$12,168,000.

The purchase price for the above acquisition was allocated to the identifiable intangible assets acquired (which have been valued by a third party valuation specialist) based upon their estimated fair values. The acquisition was accounted for under the purchase method of accounting. During 2006, no impairment loss was recorded in connection with the acquired intangible assets. See also Note 1e to our Consolidated Financial Statements included in this annual report.

In April 2007 we acquired Covelight Systems, Inc. (“Covelight”) by way of merger. The total consideration for this acquisition is up to \$16 million, of which \$7.5 million was paid in cash and an additional amount of up to \$8.5 million, which is contingent upon sales performance targets, may be due by April 2008.

We have engaged a third-party valuation specialist to evaluate the identifiable assets of Covelight for the purpose of purchase price allocation. The financial statements for the second quarter of 2007 will reflect the acquisition.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with U.S. GAAP. These accounting principles require management to make certain estimates, judgments and assumptions based upon information available at the time that they are made, historical experience and various other factors that are believed to be reasonable under the circumstances. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented.

In many cases, the accounting treatment of a particular transaction is specifically dictated in U.S. GAAP and does not require management’s judgment in its application. There are also areas in which management’s judgment in selecting among available alternatives would produce a materially different result. The Company’s management has reviewed these critical accounting policies and related disclosures with the Company’s Audit Committee. See Note 2 to our Consolidated Financial Statements, which contains additional information regarding our accounting policies and other disclosures required by U.S. GAAP.

Our management believes the significant accounting policies which affect its more significant judgments and estimates used in the preparation of its consolidated financial statements and which are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue recognition;
- Accounting for doubtful accounts;

- Inventory valuation;
- Goodwill and intangible assets valuation;
- Stock based compensation;
- Income taxes; and
- Legal contingencies.

Revenue Recognition. The Company and its subsidiaries generate revenues from selling their products and post-contract customer support primarily through distributors and resellers, all of which are considered as end-users. In North America (and rarely in the rest of the world), the Company also generates revenues from direct sales to select end users.

Revenues from product sales are recognized when delivery has occurred, persuasive evidence of an agreement exists, the fee is fixed or determinable, no further obligation exists and collectability is probable.

Revenues in arrangements with multiple deliverables are recognized under the “residual method” when Vendor specific objective evidence (“VSOE”) of fair value exists for all undelivered elements, no VSOE exists for the delivered elements, and all other revenue recognition criteria are satisfied. VSOE for post-contract customer support is determined based on the price when it is sold separately in similar arrangements. The price may vary in the territories and vertical markets in which the Company conducts business. Price is determined by using a consistent percentage of the product price.

Revenue derived from post-contract customer support, which represents mainly software subscription, SUS and unit replacement and repair services, is recognized ratably over the contract period, which is typically one year.

Revenues from training and installation, which are considered as not essential to the functionality of the product, included in multiple elements arrangements are recognized at the time they are rendered. We do not have material revenues from training and installations.

The Company and its subsidiaries provide a provision for product returns and stock rotation based on their experience with historical sales returns, analysis of credit memo data and other known factors, in accordance with SFAS No. 48 “Revenue Recognition When Right of Return Exists”. If the historical data used to calculate these estimates does not properly reflect future returns, additional provision for sales returns may be required, and revenues in that period could be adversely affected.

Deferred revenue includes unearned amounts received under post-contract customer support and SUS.

Accounting for Doubtful Accounts. Our accounts receivable are derived from our sales to our customers located all over the world. We perform periodic credit evaluations of our customers’ financial condition. We maintain an allowance for doubtful accounts for estimated losses, which may result from the inability of our customers to make required payments. Management exercises judgment as to its ability to collect outstanding receivables. Allowances for doubtful accounts are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically reviewed, allowances for doubtful accounts are made based upon the age of the receivable. In determining the allowance, we analyze our historical collection experience and current economic trends. If the historical data used to calculate the allowances for doubtful accounts do not reflect the future ability to collect outstanding receivables, additional allowances for doubtful accounts may be needed and the future results of operations could be materially affected.

Inventory Valuation. At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes an analysis of sales levels by product and projections of future demand. In addition, we write off inventories that are considered obsolete. Remaining inventory balances are adjusted to the lower of cost or market value. If future demand for our old or new products, or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of sales for such period. During the first quarter of 2007 we performed an inventory write-off in an amount of \$1.4 million in connection with the anticipated release of our new generation platforms.

Goodwill and Intangible assets. Goodwill represents excess of the costs over the fair value of net assets of businesses acquired. Under SFAS No. 142, goodwill is not amortized. SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value with its carrying value. Fair value is determined using discounted cash flows and market multiples. During the year ended December 31, 2006 no such impairment losses were recorded.

Intangible assets are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. Acquired technology and customer relationships are amortized using the straight-line method over an estimated period between six to ten years during which benefits are expected to be received. During 2006, an amount of \$ 450,000 was recorded as amortization expenses, included in cost of revenues and sales and marketing expenses. As of December 31, 2006, no impairment losses have been identified.

Stock-based compensation. For a discussion of the accounting of stock-based compensation - see “Item 5 - Operating and Financial Review and Prospects - General - Amortization of stock-based compensation”, and note 2n to the financial statements.

Income Taxes. We account for income taxes in accordance with SFAS No. 109, “Accounting for Income Taxes”. This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that a portion or all deferred tax assets would not be realized.

In evaluating our ability to recover our deferred tax assets, we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we use to manage the underlying business. We are in the process of evaluating the possible impact of the adoption of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”) - see “Impact of recently issued Accounting Policies” below.

Legal Contingencies. We are a party to a few litigation proceedings as described in “Item 8 - Financial Information - Legal Proceedings”.

Impact of recently issued Accounting Standards

In June 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”). FIN 48 creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from Financial Accounting Standards Board Statement No. 5, “Accounting for Contingencies.” FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). FIN 48 applies to all tax positions related to income taxes subject to Financial Accounting Standards Board Statement No. 109, “Accounting for Income Taxes.” This includes tax positions considered to be “routine” as well as those with a high degree of uncertainty. De-recognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are in the process of evaluating the possible impact of the adoption of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”) – see “Impact of recently issued Accounting Policies” below

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We believe that SFAS No. 157 will not have a material effect on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will adopt SFAS No. 159 no later than January 1, 2008. We have not yet determined the effect that the adoption of SFAS No. 159 will have on our consolidated financial statements.

A. Operating Results

The following table sets forth, for the periods indicated, certain financial data expressed as a percentage of sales:

| | Year ended December 31, 2002 | Year ended December 31, 2003 | Year ended December 31, 2004 | Year ended December 31, 2005 | Year ended December 31, 2006 |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Sales | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 18.2 | 18.0 | 17.8 | 19.2 | 19.4 |
| Gross profit | 81.8 | 82.0 | 82.2 | 80.8 | 80.6 |
| Operating expenses: | | | | | |
| Research and development, net | 17.9 | 15.3 | 15.1 | 16.8 | 21.7 |
| Sales and marketing | 68.7 | 54.3 | 46.6 | 51.5 | 61.6 |
| General and administrative | 9.7 | 7.6 | 6.6 | 6.8 | 7.6 |
| Total operating expenses | 96.3 | 77.2 | 68.3 | 75.1 | 90.9 |
| Operating profit (loss) | (14.5) | 4.8 | 13.9 | 5.7 | (10.3) |
| Financial income, net | 9.7 | 6.9 | 6.7 | 6.6 | 9.1 |
| Income (loss) before income taxes | (4.8) | 11.7 | 20.6 | 12.3 | (1.2) |
| Income taxes | - | - | (0.5) | (0.3) | (0.4) |
| Minority interest in earnings of a subsidiary | - | (0.1) | - | - | - |
| Net income (loss) | (4.8)% | 11.6% | 20.1% | 12.0% | (1.6)% |

Geographical Distribution of Revenues

The Company operates in one reportable segment. Its total revenues are attributed to geographic areas based on the location of the end-users.

Following is the breakdown of the Company’s total revenues by geographical distribution both in U.S. dollars and as a percentage of total revenues for the years ended December 31, 2004, 2005 and 2006:

| | Year Ended December 31, 2004 | | Year Ended December 31, 2005 | | Year Ended December 31, 2006 | |
|---|------------------------------------|-----------------|------------------------------------|--------------------|------------------------------------|----------------------|
| | (in thousands of U.S. \$) | (by percentage) | (in thousands of U.S. \$) | (by percentage) | (in thousands of U.S. \$) | (by percent- age) |
| North, Central and South Americas (principally the United States) | 28,984 | 42.4% | 31,900 | 41.1% | 27,646 | 34.0% |
| EMEA (Europe, the Middle East and Africa) | 20,450 | 29.9% | 24,074 | 31.0% | 27,529 | 33.8% |
| Asia Pacific | 19,005 | 27.7% | 21,610 | 27.9% | 26,235 | 32.2% |

Breakdown of Total Revenues by Products and Services

The following table provides the breakdown of the Company’s total revenues by products and services both in U.S. dollars and as a percentage of total revenues for the years ended December 31, 2004, 2005 and 2006:

| | Year Ended December 31, 2004 | | Year Ended December 31, 2005 | | Year Ended December 31, 2006 | |
|----------|------------------------------------|-----------------|------------------------------------|-----------------|------------------------------------|-----------------|
| | (in thousands of U.S. \$) | (by percentage) | (in thousands of U.S. \$) | (by percentage) | (in thousands of U.S. \$) | (by percentage) |
| Products | 52,206 | 76.3% | 55,902 | 72.1% | 57,335 | 70.4% |
| Services | 16,233 | 23.7% | 21,682 | 27.9% | 24,075 | 29.6% |

Executive Summary - Year Ended December 31, 2006

Sales in 2006 were approximately \$81.4 million, an increase of 5% compared with sales of \$77.6 million in 2005. In 2006 we continued the trend of sequential increase in sales, year over year, since our inception. The cost of sales as percentage of revenues stayed approximately at the same level as it was in 2005. In order to continue to strengthen and broaden our product lines we have increased our investments in research and development during 2006, mainly increasing the manpower engaged in the development of our products. In order to increase market acceptance of our new products and to strengthen our branding and market penetration in certain regions, we increased our sales and marketing expenses throughout the year. Our sales increased at a lower rate than the increase of our operating expenses. As a result of the aforementioned, and as a result of the adoption of SFAS No. 123(R) for the first time in 2006, our operating results in 2006 reflected a loss of \$8.3 million, compared to an operating profit of \$4.4 million in 2005. The financial income increased due to the increase in our average cash balance throughout the year, due to the increase in interest rates and due to gains from foreign currency translation differences. Such differences resulted mainly from the increase in the value of the Euro relative to the Dollar during 2006.

In 2007 we intend to continue and increase investment in the development of new products and directions as well as in the improvement of existing products, to support continued growth in our sales and enhancement of market acceptance for our offerings, including in the branding and market penetration of the Covelight technology which become a part of our product suite starting May 2007. As a result our cost of sales, research and development and sales and marketing expenses are expected to increase compared to 2006. There is no assurance that our investment in new products and market penetration will increase our revenues and justify the additional expense.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

Revenues. Sales in 2006 were approximately \$81.4 million, including sales of products of \$57.3 million and services revenue of \$24.1 million, an increase of approximately 5% compared with sales of approximately \$77.6 million in 2005 which included sales of products of \$55.9 million and services revenue of \$21.7 million. The increase in sales was comprised of an increase of 3% in products sales and an increase of 11% in services revenue. The increase in services revenue is attributed mainly to renewal of service contracts. During 2006 we moderately increased our sales compared to 2005 but less then we expected. We attribute this to a period of uncertainty in the market following some mergers and acquisition in our industry (such as Internet Security Systems (ISS by IBM and Reflectent Software and Orbital Data by Citrix) and due to changes in our Americas sales team that was restructured in the fourth quarter of 2006. During 2006 the portion of our sales in North America decreased to 34% of our sales, compared to 41% in 2005, which led to the reorganization at the end of the year.

Cost of Sales. Cost of sales was approximately \$15.8 million in 2006, comprised of \$10.3 million as cost of products sales and \$5.5 million as cost of services revenue, compared with cost of sales of approximately \$14.9 million in 2005 which was comprised of \$9.3 million of cost of products sales and \$5.6 million as cost of services revenue. Cost of products sales as a percentage of products sales was 17.9 % in 2006, compared to approximately 16.7% in 2005. As some of the products we offer have stronger performance, the manufacturing costs for these products are higher, but these higher costs are partially offset by higher sales prices charged to our customers. Cost of sales related to services revenues in 2006 was 22.9% compared to 25.7% in 2005. As a major portion of these costs are fixed costs (mainly salaries of technical personnel), the increase in sales did not translate into the same rate of costs increase. In addition, renewal service agreements require fewer resources and as the portion of the renewal support sales is increasing, the related costs are decreasing as a percentage of sales.

Research and Development Expenses. Research and development expenses were approximately \$17.7 million in 2006, an increase of 36% compared with research and development expenses of approximately \$13.0 million in 2005. The increase is primarily due to hiring of new R&D personnel, the increase in salary level needed to obtain high level personnel and the devaluation of the dollar against the NIS, due to the depreciation of R&D equipment purchased during 2006 and due to the increased use of subcontractors and consultants to assist with and promote certain R&D projects. Additional R&D employees were hired during 2006 in order to support the development of new platforms and products, including enhancement of our quality assurance department. All R&D salaries were paid in NIS. A material part of the increase (in an amount of \$1.1 million) is also attributed to the adoption for the first time of SFAS No. 123(R) in 2006. We expect our R&D expenses to increase in 2007 due to the recruitment of additional personnel and salary increases of existing personnel.

Sales and Marketing Expenses. Sales and marketing expenses were approximately \$50.1 million in 2006, an increase of 25% compared with sales and marketing expenses of approximately \$40.0 million in 2005. Percentage-wise, the share of sales and marketing expenses of total revenues increased from 51.5% in 2005 to 61.6% in 2006. The increase of our sales and marketing expenses in 2006 is related to the continued investment in market acceptance of new products and our next generation APSolute product family, and investment in strengthening the sales teams in some of our offices in the U.S., Asia-Pacific and EMEA. The increase is also related to the adoption for the first time of SFAS No. 123(R) in 2006, which resulted in an additional expense of \$2.5 million..We anticipate increasing sales and marketing expenses also in 2007 primarily for the purposes of (i) increasing brand awareness and market acceptance of our new products (by participation in trade shows and seminars, testing and certification of our products by leading firms in the industry and receiving top analysts coverage for our products and strategy); and (ii) strengthening our international presence (by adding sales and marketing personnel, as well as technical support personnel).

General and Administrative Expenses. General and administrative expenses were approximately \$6.2 million in 2006, compared with general and administrative expenses of approximately \$5.2 million in 2005. This increase is primarily due to the increase of salaries expenses which resulted from hiring of new personnel, salary adjustments, the devaluation of the U.S. dollar against the NIS (as most of the general and administrative salaries are paid in NIS) and the first adoption of SFAS No. 123(R) in 2006, which added an expense of approximately \$0.8 million

Financial Income, Net. Financial income, net was approximately \$7.4 million in 2006, an increase of approximately 42.3% compared with financing income, net of approximately \$5.2 million in 2005. This increase is attributable to the increase in the average balance of our cash and cash equivalents, bank deposits and marketable securities during the year, before \$11.1 million was invested in the buy-back of our shares, an increase in interest rates and gains from foreign currency translation differences.

Income Taxes. Income taxes were approximately a \$0.4 million benefit in 2006 (in and outside Israel), compared to approximately a \$0.2 million benefit in 2005. This amount derives mainly from current taxes and change in deferred taxes.

Year Ended December 31, 2005 Compared with Year Ended December 31, 2004

Revenues. Sales in 2005 were approximately \$77.6 million, including sales of products of \$55.9 million and services revenue of \$21.7 million, an increase of approximately 13% compared with total sales of approximately \$68.4 million in 2004 which included sales of products of \$52.2 million and services revenue of \$16.2 million. The growth in sales during 2005 is primarily attributable to the expansion of our sales and marketing activities, and a slight improvement in the market environment and corporate spending, as well as an increase resulting from sales of service renewal contracts related to the a larger installed units base.

Cost of Revenues. Cost of sales was approximately \$14.9 million in 2005, comprised of \$9.3 million as cost of product sales and \$5.6 million as cost of services revenue, compared with cost of sales of approximately \$12.2 million in 2004 which was comprised of \$8.1 million of cost of products sales and \$4.1 million as cost of services revenue. Cost of products sales as a percentage of products sales was 16.7 % in 2005, compared to approximately 15.5% in 2004. This increase is primarily attributable to the introduction of new products as well as a different mix of products. Cost of sales related to services revenues in 2005 was 25.7% compared to 25.3% in 2004.

Research and Development Expenses. Research and development expenses were approximately \$13.0 million in 2005, an increase of 26% compared with research and development expenses of approximately \$10.3 million in 2004. The increase is primarily due to hiring of new R&D personnel. Additional R&D employees were hired during 2005 in order to support our Application Delivery and Network Security capabilities and development of new platforms and products, including enhancement of our quality assurance department. A small part of the increase was offset due to the decrease in the U.S. dollar cost of our salaries for our research and development staff caused by the decrease in value of the NIS against the dollar. All these salaries were paid in NIS.

Sales and Marketing Expenses. Sales and marketing expenses were approximately \$40.0 million in 2005, an increase of 25% compared with sales and marketing expenses of approximately \$31.9 million in 2004. Percentage-wise, the share of sales and marketing expenses of total revenues increased from 46.6% in 2004 to 51.5% in 2005. The increase of our sales and marketing expenses in 2005 is related to the increase in sales as well as the continued investment in market acceptance of new products and our next generation APSolute product family, and investment in new geographical markets, mainly in Europe and the Far East.

General and Administrative Expenses. General and administrative expenses were approximately \$5.2 million in 2005, an increase of approximately 16.7% compared with general and administrative expenses of approximately \$4.5 million in 2004. This increase is primarily attributable to the actions we have taken in order to improve our information systems and to professional services received in order to prepare our Company to comply with the Sarbanes-Oxley Act of 2002.

Financial Income, Net. Financial income, net was approximately \$5.2 million in 2005, an increase of approximately 13% compared with financing income, net of approximately \$4.6 million in 2004. This increase is attributable to the total increase in cash and cash equivalents, bank deposits and marketable securities and increase in interest rates which was partially offset by a loss from foreign currency translation differences which are included in financial income, caused mainly by a decrease in the value of the Euro relative to the dollar.

Income Taxes. Income taxes were approximately \$0.3 million in 2005 (in and outside Israel), the same as in 2004. This amount derives mainly from current taxes and change in deferred taxes.

B. Liquidity and Capital Resources

In our opinion, the Company’s working capital is sufficient for the Company’s present requirements. Since our inception, we have financed our operations through a combination of issuing debt and/or equity securities, including two public offerings, research and development and/or marketing grants from the Government of Israel and cash generated by operations. We raised approximately \$12.9 million in two private placements, in November 1997 and June 1999. In October 1999, we raised net proceeds of approximately \$56.8 million in the initial public offering of our ordinary shares. In January 2000, we raised net proceeds to the Company of approximately \$59.8 million in a public offering of our ordinary shares.

Capital expenditures for the years ended December 31, 2004, 2005 and 2006 were approximately \$2.4 million , \$3.6 million and \$5.8 million, respectively. These expenditures were mainly comprised of machinery and equipment, computers, lab equipment and testing tools and ERP systems. During 2006 we invested in purchasing and implementing a new ERP system which became operational in the beginning of 2007. Additional investments related to the implementation of the ERP system and to the purchase and implementation of additional modules are expected to take place during 2007. We may have additional capital spending consistent with possible growth in our operations, infrastructure and personnel.

Net cash provided by operating activities was approximately \$7.3 million for the year ended December 31, 2006, compared with \$ 13.9 million for the year ended December 31, 2005 and \$15.2 million for the year ended December 31, 2004. Net cash provided by operating activities for the years 2006, 2005 and 2004 changed primarily due to the changes in our operating profit and loss in these years, mainly as a result of the increase in operating expenses - which, for example, in 2006 and in 2005 exceeded the pace of increase in sales. Net cash provided by operating activities for 2006 consisted primarily of net loss plus amortization of stock based compensation, plus depreciation and amortization, plus increase in trade payables and deferred revenues, offset by an increase in trade receivables and in inventories. Net cash provided by operating activities for the year 2005 consisted primarily of net income plus an increase in deferred revenues and other payables and accrued expenses, offset by an increase in trade receivables and inventories. Net cash provided by operating activities for 2004 consisted primarily of net income plus an increase in deferred revenues, offset by an increase in trade receivables and inventories.

Net cash used in investing activities was approximately \$39.8 million for 2006, compared to net cash provided by investing activities of approximately \$26.3 million for 2005, and to net cash used in investing activities of approximately \$45.0 million for 2004. Cash was used in 2006 mainly for the purchase of marketable securities and also for purchase of property and equipment, and for the completion of the acquisition of V-Secure Technologies Inc., partially offset by the sale and redemption of marketable securities and bank deposits. Cash was provided in 2005 mainly from redemption of long-term bank deposits which was partially offset by the purchase of marketable securities and by the acquisition of the business of V-Secure Technologies Inc. and other property and equipment. Cash was used in 2004 mainly to purchase long-term marketable securities and for capital expenditures.

Net cash provided by financing activities was \$1.6, \$7.3 and \$6.9 million for the years ended December 31, 2006, 2005 and 2004, respectively, generated from options exercised by our employees under the Key Employee Share Option Plans and Employee Stock Purchase Plans (see “Item 6 - Directors Senior Management and Employees - Key Employee Share Incentive Plan and Employee Stock Purchase Plan”). In 2006 the amount generated from options exercises was nearly fully offset by the repurchase of our shares.

As of December 31, 2006, we had cash and cash equivalents, including short-term and long-term bank deposits and marketable securities of approximately \$164.1 million, as compared to approximately \$164.5 million as of December 31, 2005. Our capital requirements depend on numerous factors, including market acceptance of our products and the resources we allocate to our operating expenses. Since our inception, we have experienced substantial increases in our expenditures consistent with growth in our operations and personnel, and we may increase our expenditures in the foreseeable future in order to execute our strategy. We anticipate that operating activities as well as capital expenditures will demand the use of our cash resources. We believe that cash balances will provide sufficient cash resources to finance our operations and the projected expansion of our marketing and sales activities and research and development efforts for a period of no less than the next twelve months.

Related Parties

We have entered into a number of agreements with certain companies, of which Yehuda and Zohar Zisapel are co-founders, directors and/or principal shareholders, collectively known as the RAD-Bynet Group. Of these agreements, the lease for our headquarters in Tel-Aviv is material to our operations. We believe that the terms of the transactions in which we have entered with members of the RAD-Bynet Group are not different in any material respect from terms we could obtain from unaffiliated third parties. The pricing of the transactions was arrived at based on negotiations between the parties. Members of our management reviewed the pricing of the lease agreements and confirmed that they were not different than that which could have been obtained from unaffiliated third parties. We believe, however, that due to the affiliation between us and the RAD-Bynet Group, we have greater flexibility in certain terms than might be available from unaffiliated third parties on similar issues. In the event that the transaction with members of the RAD-Bynet Group is terminated and we enter into similar transactions with unaffiliated third parties, that flexibility may not be available to us.

In addition, the Company purchases different services from third parties at special rates offered to the RAD-Bynet Group, such as car leases, maintenance, insurance and communication services. In the event that we cease to be a member of the RAD-Bynet Group, we may not be able to obtain the current rates for such services.

Impact of Inflation and Currency Fluctuations

A devaluation of the U.S. dollar against the NIS and or appreciation or depreciation of the Euro to the dollar has direct influence on the US dollar cost of our operations. Most of our sales are denominated in dollars or are dollar-linked and we incur a portion of our expenses, principally salaries and related personnel expenses, in Israel - in NIS, and in Europe - in Euros. An appreciation of the NIS, or, unless offset by a devaluation of the NIS, inflation in Israel, will have a negative effect on our profitability. Conversely, devaluations of the NIS relative to the U.S. dollar at a rate in excess of the rate of inflation in Israel could have a positive effect on our profitability. In 2004 we began selling to the European Union countries in Euros instead of dollars in order to reduce the exposure to fluctuations in the Euro exchange rate. We are still exposed to the risk of an appreciation of the Euro in the event our expenses in Euros exceed our sales in Euros. In addition, if the Euro devaluates relative to the U.S. dollar and sales in Euros exceed expenses incurred in Euros, our operating profit may be negatively affected as a result of a decrease in the U.S. dollar value of our sales.

The following table presents information about the rate of inflation in Israel and the changes in the exchange rates of the U.S. dollar relative to the NIS:

| <u>Year ended December 31,</u> | <u>Israeli inflation rate</u> | <u>U.S. dollar against NIS</u> |
|--------------------------------|-------------------------------|--------------------------------|
| 2002 | 6.5% | 7.3% |
| 2003 | (1.9)% | (7.6)% |
| 2004 | 1.2% | (1.6)% |
| 2005 | 2.4% | 6.8% |
| 2006 | (0.1)% | (8.2)% |

We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of the devaluation lags behind inflation in Israel, or if there will be a revaluation of the NIS or a revaluation or devaluation of the Euro against the U.S. dollar. Because exchange rates between the NIS and the dollar and between the Euro and the dollar fluctuate continuously, exchange rate fluctuations and especially larger periodic devaluations or revaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in the statement of operations.

Market Risk

We do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk, with the exception of the following: Approximately 6% of our investment portfolio is invested in a structured note with guaranteed principal and changing interest. An increase in short-term interest rates will negatively affect the income received from this note. Approximately 70% of our investment portfolio is invested in high-rated marketable securities, mainly U.S. government and agency bonds, and corporate bonds. Since these investments carry fixed interest rates, interest income over the holding period is not sensitive to changes in interest rates. We have no debt.

C. Research and Development, Patents and License

In order to accommodate the rapidly changing needs of our markets, we place considerable emphasis on research and development projects designed to improve our existing product lines, develop new product lines and customize our products to meet our customers’ needs. As of December 31, 2006, we had 163 employees engaged primarily in research and development activities, compared to 122 employees at the end of 2005.

For a discussion regarding the benefits provided under programs of the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor - see “Item 4 - Information on the Company - Business Overview - Israeli Office of Chief Scientist”.

D. Trend Information

For a discussion of recent market trends - see “Item 5 - Operating and Financial Review and Prospects - General - Market Trends.”

E. Tabular Disclosure of Contractual Obligations

Our principal commitments consist of outstanding operating leases for the Company’s facilities. The lease agreements expire in the years 2007 to 2010 (some with renewal options). Our future minimum payments under non-cancelable operating lease agreements at December 31, 2006, are approximately as follows:

| | Payments Due By Period (US\$ in thousands) | | | | |
|------------------------------------|--|------------------|-----------|-----------|-------------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Operating leases | 2,735 | 1,606 | 1,069 | 60 | - |
| Total contractual cash obligations | 2,735 | 1,606 | 1,069 | 60 | - |

We operate from leased premises mainly in Tel Aviv and Jerusalem in Israel and New Jersey and California in the United States. We also lease premises for our subsidiaries’, representative offices’ and branches’ activities, in several locations in the United States, Europe and Asia Pacific. Our aggregate annual rent obligations under these leases were approximately \$1,948,000 for 2006.

ITEM 6. Directors, Senior Management and Employees

Directors and Senior Management

The following table lists our current directors and executive officers:

| Name | Age | Position |
|-----------------------------|-----|---|
| Christopher McCleary(1) | 54 | Executive Chairman of the Board of Directors |
| Roy Zisapel(2) | 36 | Chief Executive Officer, President and Director |
| Meir Moshe | 53 | Chief Financial Officer |
| Larry Marino | 50 | President, Radware Inc. |
| Vered Raviv-Schwarz | 38 | General Counsel and Secretary |
| Christine Aruza | 39 | VP Corporate Marketing |
| Amir Peles | 35 | Vice President, Chief Technology Officer |
| Yuval Pemper | 36 | Vice President, Research and Development |
| Yehuda Zisapel (3) | 64 | Director |
| Zohar Gilon (3)(4)(5)(6) | 59 | Director |
| Orna Berry(3)(4)(5)(6) | 58 | Director |
| Liora Katzenstein (2)(5)(6) | 50 | Director |
| Hagen Hultzsch (1)(5) | 66 | Director |
| Herbert Anderson (7) | 68 | Director |

- (1) Term as director expires at the annual meeting of shareholders to be held in 2008.
- (2) Term as director expires at the annual meeting of shareholders to be held in 2007.
- (3) Term as director expires at the annual meeting of shareholders to be held in 2009.
- (4) External Director, as defined in the Israeli Companies Law.
- (5) Qualified as an Independent Director, as determined under the Nasdaq rules.
- (6) Serves on the Audit Committee of the Board of Directors.
- (7) Nominated until the next annual meeting and therefore is not a part of any class.

Christopher McCleary has served as our Chairman of the Board of Directors since August 2006, and as a director since February 2000. Beginning June 1, 2007, Mr. McCleary serves as our Executive Chairman. From January 2004 until May 31, 2007, Mr. McCleary was a Partner at Blue Chip Venture Company since January 2004. He was previously the founder, Chairman and CEO of Evergreen Assurance, Incorporated from January 2002 to January 2004. During the years 2001, Mr. McCleary was non-executive Chairman of USinternetworking Inc. and served as the Chairman and Chief Executive Officer of USi from January 1998 until June 2000. Prior to founding USi, he was the Chairman and Chief Executive Officer of DIGEX, Inc. from January 1996 to December 1997. From October 1990 to January 1996, Mr. McCleary served as Vice President and General Manager for Satellite Telephone Service at American Mobile Satellite Corporation, a satellite communications company. Mr. McCleary currently serves as Chairman and a director of JackBe, Inc. and chairman and a director of SaaS Capital, Inc. He also serves on the Board of The State of Maryland Venture Fund and the City of Baltimore Emerging Technology Center. Mr. McCleary has a Bachelor of General Studies from the University of Kentucky.

Roy Zisapel, co-founder of our Company, has served as our President and Chief Executive Officer and a director since our inception in May 1996. Mr. Zisapel also serves as a director of Radware Inc. and other subsidiaries. From February 1996 to March 1997, Mr. Zisapel was a team leader of research and development projects for RND Networks Ltd. From July 1994 to February 1996, Mr. Zisapel was employed as a software engineer for unaffiliated companies in Israel. Mr. Zisapel has a B.Sc. degree in mathematics and computer science from Tel Aviv University. Roy Zisapel is the son of Yehuda Zisapel, who is a director of the Company.

Meir Moshe has served as our Chief Financial Officer since June 1999. From June 1997 to June 1999, Mr. Moshe was Chief Financial Officer, Secretary and Treasurer of ForSoft Ltd. Mr. Moshe holds a B.Sc. in economics and accounting from Tel Aviv University and is a certified public accountant.

Larry Marino joined us in January 2006 as President of Radware, Inc. Previously, Mr. Marino held various executive positions at AT&T and has over 25 years of experience in the telecommunications industry. Mr. Marino holds a BS in Electrical Engineering from Worcester Polytechnic Institute and an M.B.A. from the University of Pennsylvania, Wharton School of Business.

Vered Raviv-Schwarz has served as our General Counsel since July 2000. From May 1995 to June 2000, Mrs. Raviv-Schwarz was an Associate at the law firm of M. Seligman & Co. Mrs. Raviv-Schwarz has LL.B. and LL.M. degrees from Tel Aviv University.

Christine D. Aruza has served as our Vice President of Corporate Marketing since January 2007. From June 2006 to December 2006, Ms. Aruza served as our Director of Corporate Communications. Prior to joining Radware, Ms. Aruza had her own marketing consultancy from January 2005 - June 2006 and was SVP of Marketing at Enamics, Inc. from November 2002 to January 2005. During her career, she has also held management positions in sales, marketing and business development with companies ranging from fast-growth start-ups to the Fortune 50 (Hewlett-Packard). Ms. Aruza is a 2004 CMO Council inductee and graduated magna cum laude with a B.A. in liberal arts & sciences from the University of Florida.

Amir Peles has served as our Vice President, Chief Technology Officer since April 2000. From July 1997 through March 2000, Mr. Peles served as our Vice President of Research and Development since July 1997. From July 1996 to July 1997, Mr. Peles was a senior team leader at Amdocs Corporation. Mr. Peles has a B.Sc. degree in computer science, statistics and operations research from Tel Aviv University.

Yuval Pemper has served as Radware’s Vice President of R&D since July 2006. Mr. Pemper joined Radware in November 2001 and previously served as CertainT 100 Development Team Leader, Application Infrastructure Development Group Leader and Director of Hardware and Software Infrastructure. Prior to his tenure at Radware, Mr. Pemper worked for various startups and for Comverse Network Systems. He is a graduate of the Israeli military’s prestigious Talpiyot program and served as a research and development officer in the Israeli Navy for 5 years between 1991 and 1996. Mr. Pemper holds a B.Sc. cum laude in physics and mathematics from the Hebrew University, Jerusalem, and a M.Sc. cum laude in electrical engineering, physical electronics from Tel Aviv University.

Yehuda Zisapel, co-founder of our Company, has served as a member of our Board of Directors since our inception in May 1996 and served as Chairman of our Board of Directors until August 2006. In addition, Mr. Zisapel serves as a director of Radware Inc. Mr. Zisapel is also a founder and a director of RAD Data Communications Ltd., a worldwide data communications company headquartered in Israel, and BYNET Data Communications Ltd., a distributor of data communications products in Israel, Chairman of the Board of Directors of RIT Technologies Ltd., and a director of other companies in the RAD-Bynet Group, including SILICOM Ltd., and several private companies. Mr. Zisapel has a B.Sc. and an M.Sc. degree in electrical engineering as well as an Award of Honorary Doctorate (DHC-Doctor Honoris Causa) from the Technion, Israel Institute of Technology and an M.B.A. degree from Tel Aviv University. Yehuda Zisapel is the father of Roy Zisapel director, President and Chief Executive Officer of the Company.

Prof. Liora Katzenstein has served as a director since January 2001. In 1996 Prof. Katzenstein founded and has since served as President of ISEMI - Israel School of Entrepreneurial Management and Innovation (Part of Swinburne University of Technology's (Australia) Graduate School of Entrepreneurship). Prof. Katzenstein also lectured in Business Administration at the Harvard Business School, Tel Aviv University, Nanyang Technological University (Singapore), the Technion, Israel Institute of Technology and in the Israeli Management Center. From 1995 to 1996, Prof. Katzenstein was an Associate Dean at TISOM - Tel Aviv International School of Business, and from 1992 to 1995 she was a Senior Lecturer at the Tel Aviv University Recanati Graduate School of Business Administration. Prof. Katzenstein also serves as a director in RiT Technologies Ltd., Polysac Ltd., Palafric Investments Ltd., Clal Insurance Company and Degem Systems Ltd. Prof. Katzenstein has a 'License' and a Ph.D. in International Economics from the Graduate Institute of International Studies, University of Geneva, and an MALD in Law and Diplomacy from the Fletcher School of Law and Diplomacy, Tufts University.

Dr. Hagen Hultzs has served as a director since January, 2005. Dr. Hultzs served on the Board of Management of Deutsche Telekom AG from 1993 until 2001. Since 2001, Dr. Hultzs has served on the Boards or Advisory Boards of several companies and academic institutions. Dr. Hultzs serves as a Board Member of the following companies: TranSwitch Corporation Inc., SCM-Microsystems Inc. and RIT Ltd. and he is a member of the advisory boards of several private and public technology companies. Dr. Hultzs holds a PhD. from Mainz University.

Zohar Gilon has served as a director since October 2006. Mr. Gilon serves as a General Partner and Managing Director of Tamar Technologies Ventures, a venture capital fund investing in Israel and the United States. From 1993 until 1995, Mr. Gilon served as President of W.S.P. Capital Holdings Ltd., which provides investment banking and underwriting services in Israel and invests in real estate and high-technology investments in Israel and abroad. Currently, Mr. Gilon serves as a director of the following companies: RADCom Ltd., Orsense Ltd., Wisair Ltd., Oberon Media Inc., Axerra Networks, Inc., Syncho Ltd., PayoneerInc. and RADVentures, an investment fund for RAD Data Communications employees. Mr. Gilon holds a B.Sc. degree in electrical engineering from the Technion, Israel Institute of Technology, and an M.B.A. degree from Tel Aviv University.

Dr. Orna Berry has served as a director since October 2006. Dr Berry has been a Venture Partner in Gemini Israel funds since August 2000. Since December 2005, she has served as the Chairperson of Prime Sense Ltd., and since January 2005, as the Chairperson of Adamind Ltd., a UK public company. Dr. Berry is a member of the European Union Research Advisory Board (EURAB) and a member of the Association of Computing Machines' (ACM) task force on job migration and globalization (TFJM). From 1997 to 2000 she acted as Chief Scientist and Director of the Industrial R&D Administration of the Ministry of Industry, Trade and Labor of the Government of Israel. In 1993 she co-founded ORNET Data Communication Technologies Ltd. and served as co-president of ORNET until 1997. Dr. Berry holds a Ph.D. in computer science from the University of Southern California, and M.A. and B.A. degrees in statistics and mathematics from Tel Aviv University and Haifa University, respectively. Currently, she serves as a director of the following companies: Aladdin Knowledge Systems Ltd., Poalim Capital Markets, Mer Telemanagement Solutions Ltd., Commtouch Software Ltd and Prime Sense Ltd.

Herbert Anderson was nominated to He will be considered for election for a three year period at the Company's annual meeting expected to be held in July 2007. our Board of Directors in January 2007. Mr. Anderson served as Corporate Vice President of Northrop Grumman Corporation and President of Northrop Grumman Information Technology until his retirement in 2004. Mr. Anderson first joined Northrop in 1984 as Vice President of Information Resources Management for the company's former B-2 division, after holding senior management positions with the Western Gear, McGraw-Edison and Eaton corporations. Mr. Anderson is a former member of the President's National Security Telecommunications Advisory Committee and of the Secretary of the Air Force Advisory Group, and a former board member of the Professional Services Council and the United Services Organization. Mr. Anderson currently serves on the Board of CACI, International. Mr. Andersen holds a B.Sc. degree in business management from the University of Wisconsin.

Except as described above, there are no family relationships between any of the directors or members of senior management named above.

Under Nasdaq requirements, commencing July 31, 2005, a majority of the members of our Board of Directors are required to be “independent,” as defined thereunder. We currently satisfy this requirement as Mr. Zohar Gilon, Dr. Orna Berry, Prof. Liora Katzenstein, Mr. Herbert Anderson and Dr. Hagen Hultzsch, i.e., five out of our eight directors, qualify as independent directors under such Nasdaq rules.

Compensation

Under our articles of association, no director may be paid any remuneration by the company for his services as director except as may be approved pursuant to the provisions of the Companies Law, which generally require the approval of the Audit Committee, the Board of Directors and then the approval of the shareholders of the company, in that order. An external director is entitled to consideration and reimbursement of expenses only as provided in regulations promulgated under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with his service as an external director.

The following table sets forth all compensation we paid with respect to all of our directors and officers as a group for the year ended December 31, 2006. The table does not include any amounts we paid to reimburse any of our affiliates for costs incurred in providing us with services during such period.

| | Salaries, fees, commissions and bonuses | Pension, retirement and other similar benefits |
|---|---|---|
| All directors and officers as a group, consisting of 14 persons | \$ 1,532,000 | \$ 130,000 |

As of June 3, 2007, our directors and officers as a group, consisting of 14 persons, held options to purchase an aggregate of 1,181,500 ordinary shares. Beginning January 2006, our non-employee directors are entitled to the following compensation: (a) an annual fee of \$20,000; and (b) a grant of options under our stock option plans to purchase 10,000 ordinary shares for each year in which such non-employee director holds office. The options will be granted for three (3) years in advance, and therefore every director will receive an initial grant of options to purchase 30,000 ordinary shares, which shall vest over a period of three years, with a third (10,000) to vest upon each anniversary of service, provided that the director still serves on the Company’s Board of Directors on such date. The grant will be made on the date of the director’s election, and thereafter, every three years, if reelected, an additional grant of options to purchase an additional 30,000 ordinary shares will be made on the date of each annual meeting in which such director is reelected. The exercise price of all options shall be equal to the fair market value of the ordinary shares on the date of the grant (i.e., an exercise price equal to the market price of our ordinary shares on the date of the annual meeting approving the election or reelection of a director); (c) a special attendance fee of \$3,000 for the director’s attendance (in person) at a meeting of the Board of Directors held outside his/her country of residence; and (d) an annual fee of \$5,000 for each director who presides as a chairman of any committee of the Board of Directors.

The above compensation policy was approved by our Compensation Committee, Board of Directors, Audit Committee and shareholders.

During 2006, we granted to our directors and officers options to purchase 240,500 ordinary shares, in the aggregate, at a weighted average exercise price of \$15.64. The options expire sixty-two months after grant.

Chief Executive Officer Compensation

On October 4, 2006 our shareholders approved the increase of the Chief Executive Officer’s compensation, entitling him to a base salary in NIS equivalent to \$200,000 per annum and, effective as of the year 2007, an annual bonus of up to \$100,000, subject to achievement of certain milestones to be determined by the Compensation Committee and approved by the Audit Committee and the Board of Directors before the beginning of each year. The Compensation Committee determined the following milestones for the year 2007 - 75% of the bonus will be based on achievement of the target revenue. 25% will be based on the earnings per share (with \$750 being paid for each 1 cent of earnings per share), but will be paid only if the annual revenue target is met.

Board Practices

Introduction

According to the Israeli Companies Law and our articles of association, the oversight of the management of our business is vested in our Board of Directors. The Board of Directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. As part of its powers, our Board of Directors may cause us to borrow or secure payment of any sum or sums of money for our purposes, at times and upon terms and conditions as it determines, including the grant of security interests in all or any part of our property.

Our articles of association provide for a Board of Directors of not less than five and not more than nine directors. Currently, our board consists of eight directors, including the external directors (as described below). In accordance with current Nasdaq requirements, nominees for election as directors are approved and recommended to the Board of Directors by a decision of a majority of our independent directors. Under the Companies Law, our Board of Directors is required to determine the minimum number of directors having accounting and financial expertise, as defined in regulations promulgated under the Companies Law, that our Board of Directors should have. In determining the number of directors required to have such expertise, the Board of Directors must consider, among other things, the type and size of the company and the scope and complexity of its operations. Our Board of Directors has determined that we require at least one director with the requisite financial and accounting expertise and that Zohar Gilon has such expertise.

Since our ordinary shares are listed for quotation on the Nasdaq Global Market, we are subject to the rules of the Nasdaq applicable to listed companies. In addition, since we are incorporated as an Israeli company, we are subject to the provisions of the Israeli Companies Law and the regulations adopted thereunder.

Staggered Board

In accordance with the terms of our articles of association, our Board of Directors (other than our external directors) is divided into three classes with each class serving until the third annual meeting following their election as follows:

| Class* | Term expiring at the annual meeting for the year | Directors |
|-----------|--|---|
| Class I | 2009 | Yehuda Zisapel |
| Class II | 2007 | Roy Zisapel and Prof. Liora Katzenstein |
| Class III | 2008 | Christopher McCleary, Hagen Hultzsch |

Mr. Herbert Anderson was nominated by the Board of Directors until the next annual meeting of shareholders.

At each annual meeting of shareholders after the initial classification, the successors to directors whose terms will then expire will be elected to serve from the time of election and qualification until the third annual meeting following the election. Directors, other than external directors, are elected by a simple majority of the votes cast, whereas their removal from office requires the vote of a majority of at least seventy-five percent of the voting power represented at the general meeting. Any additional directorships resulting from an increase in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of the directors. This classification of our Board of Directors may have the effect of delaying or preventing changes in control or management of our company.

The above classification does not apply to Mr. Zohar Gilon and Dr. Orna Berry, who were appointed as external directors whose term of appointment ends in 2009.

External Directors

Qualifications of External Directors

Under the Companies Law, companies incorporated under the laws of Israel whose shares are listed for trading on a stock exchange or have been offered to the public in or outside of Israel are required to appoint at least two external directors. External directors are required to possess professional qualifications as set out in regulations promulgated under the Companies Law. The Companies Law provides that a person may not be appointed as an external director if the person or such person’s relative, partner, employer or any entity under the person’s control has, as of the person’s appointment to serve as an external director, or had during the two years preceding that date, any affiliation with:

- the Company;
- any entity controlling the Company; or
- any entity controlled by the Company or by this controlling entity.

The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder, excluding service as a director that was appointed to serve as an external director of a company that is about to make its initial public offering.

The Companies Law defines the term “office holder” of a company to include a director, the chief executive officer, the chief financial officer, a vice president and any officer of the company that reports directly to the chief executive officer.

No person can serve as an external director if the person's position or other business creates, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person’s ability to serve as an external director. Until the lapse of two years from termination of office as an external director, a company may not engage an external director to serve as an office holder and cannot employ or receive services from that person, either directly or indirectly, including through a corporation controlled by that person.

Election of External Directors

External directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

- At least one third of the shares of non-controlling shareholders voted at the meeting in favor of the election; or

- The total number of shares voted against the election of the external director does not exceed one percent of the aggregate voting rights in the Company.

The initial term of an external director is three years and may be extended for one additional three year term. Thereafter, he or she may be reelected by our shareholders for additional periods of up to three years each only if the Audit Committee and Board of Directors confirm that, in light of the external director’s expertise and special contribution to the work of the Board of Directors and its committees, the reelection for such additional period is beneficial to the Company. External directors may be removed from office only by the vote of the same percentage of shareholders as is required for their election, or by a court only if they cease to meet the statutory qualifications for appointment or if they violate their duty of loyalty to the company. Each committee of a company’s board of directors is required to include at least one external director, except for the Audit Committee which is required to include all the external directors.

Currently, Mr.Zohar Gilon and Dr. Orna Berry qualify as external directors under the Companies Law and were elected by the general shareholders meeting held in October 2006, to serve as our external directors for a three-year term ending October 2009.

Pursuant to an amendment to the Companies Law, effective as of January 19, 2006, (1) an external director must have either “accounting and financial expertise” or “professional qualifications” (as such terms are defined in regulations promulgated under the Companies Law) and (2) at least one of the external directors must have “accounting and financial expertise.” These requirements will apply to us upon the election of one or more external directors.

Board Meetings

Our Board of Directors met 8 times during 2006 and all directors attended at least 75% of all Board meetings.

Our Committees

The Board of Directors appoints committees to help carry out its duties. Each committee reviews the results of its meetings with the full Board of Directors. The Board of Directors established its Audit and Share Incentive Committees in 1999, and its Compensation Committee (which replaced the Share Incentive Committee) in 2004. Only non-employee directors serve on our Audit Committee and Compensation Committee.

Audit Committee

Nasdaq Requirements

Our ordinary shares are listed for quotation on the Nasdaq Global Market and we are subject to the rules of the Nasdaq applicable to listed companies. Under the Nasdaq rules, we are required to have an audit committee consisting of at least three independent directors, all of whom are financially literate and one of whom has accounting or related financial management expertise. The members of the Audit Committee, Mr. Zohar Gilon, Dr. Orna Berry and Prof. Liora Katzenstein qualify as independent directors under the current Nasdaq listing requirements. The Board of Directors has determined that each Audit Committee member is “financially literate” as such term is defined by the Nasdaq rules and that Mr. Zohar Gilon is an “audit committee financial expert” within the meaning of the current rules of the Securities and Exchange Commission. In accordance with Nasdaq listing requirements, the Audit Committee has adopted a charter, which sets forth the Committee’s responsibilities.

The Audit Committee assists the Board of Directors in fulfilling its responsibility for oversight of the quality and integrity of our accounting, auditing and financial reporting practices and financial statements and the independence qualifications and performance of our independent auditors. The Audit Committee also has the sole authority and responsibility to select, evaluate and, where appropriate, recommend to replace the independent auditors (or to nominate the independent auditors subject to shareholder approval) and to pre-approve audit engagement fees and all permitted non-audit services and fees.

The Audit Committee met 5 times during fiscal year 2006 and all members attended at least 75% of all Audit Committee meetings.

Israeli Companies Law Requirements

Under the Companies Law, our Board of Directors is required to appoint an audit committee, comprised of at least three directors including all of the external directors, but excluding:

- the chairman of the Board of Directors;
- a controlling shareholder or a relative of a controlling shareholder; and
- any director employed by the Company or who provides services to the Company on a regular basis.

In accordance with the Companies Law, the duty of our Audit Committee is, in addition to the requirements imposed by Nasdaq rules (1) to identify irregularities in the business management of the Company, including in consultation with the internal auditor and/or the Company's independent accountants, and to recommend remedial measures to the Board of Directors; and (2) to review, and, where appropriate, approve certain interested party transactions specified under the Companies Law, as more fully described below.

Approval of Interested Party Transactions

The approval of the audit committee is required under the Israeli Companies Law to effect specified actions and transactions with office holders, controlling shareholders and entities in which they have a personal interest. An audit committee may not approve an action or a transaction with interested parties or with an office holder unless at the time of approval the two external directors are serving as members of the audit committee and at least one of whom was present at the meeting in which an approval was granted. The Companies Law defines the term “interested party” to include a person who holds 5% or more of the Company’s outstanding share capital or voting rights, a person who has the right to appoint one or more directors or the general manager, or any person who serves as a director or as the general manager.

Compensation Committee

Our compensation committee consists of two our independent directors, Dr. Hagen Hultzsch and Dr. Orna Berry. This committee was created in 1999 as the Share Incentive Committee and was renamed the Compensation Committee in 2004. The Compensation Committee met 5 times during fiscal year 2006 and all members attended at least 75% of the meetings. On March 8, 2005, our compensation committee adopted a charter, which sets forth the committee’s responsibilities. Pursuant to the charter, the compensation committee is authorized to make decisions regarding executive compensation and terms and conditions of employment, to follow market trends and provide recommendations to the Board of Directors in connection with the Company’s general compensation philosophy and policies, as well as to recommend that the Board of Directors issue options under our stock option plans. The Compensation Committee specifically approves and reviews, on behalf of the Board of Directors, the amounts and types of compensation to be paid to the Company’s executive officers and non-employee directors.

Nomination of Directors

Our Independent directors consider and vote upon nominations to our Board of Directors.

Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor proposed by the audit committee. The role of the internal auditor is to examine, among other things, whether the Company's conduct complies with applicable law and orderly business procedure. The internal auditor may participate in all audit committee meetings and has the right to demand that the chairman of the audit committee convene a meeting. Under the Companies Law, the internal auditor may be an employee of the Company but may not be an interested party, an office holder or a relative of any of the foregoing, nor may the internal auditor be the Company's independent accountant or its representative. Mrs. Sharon Vitkovski-Tabib, CPA, of BDO Ziv Haft, CPAs, is our internal auditor.

Approval of Specified Related Party Transactions Under Israeli Law

Fiduciary Duties of Office Holders

The Companies Law imposes a duty of care and a duty of loyalty on all office holders of a company.

The duty of care requires an office holder to act with the level of care with which a reasonable office holder in the same position would have acted under the same circumstances. The duty of care includes a duty to use reasonable means to obtain:

- Information regarding the advisability of a given action submitted for his approval or performed by him or her by virtue of his or her position; and
- All other important information pertaining to these actions.

The duty of loyalty of an office holder includes a duty to:

- Refrain from any conflict of interest between the performance of his/her duties in the Company and the performance of his other duties or his personal affairs;
- Refrain from any activity that is competitive with the Company;
- Refrain from exploiting any business opportunity of the company to receive a personal gain for himself or others; and
- Disclose to the company any information or documents relating to the Company's affairs which the office holder has received due to his/her position as an office holder.

Disclosure of Personal Interest of an Office Holder

The Companies Law requires that an office holder of a company disclose to the company any personal interest that he may have and all related material information known to him, in connection with any existing or proposed transaction by the company. The disclosure is required to be made promptly and in any event no later than the board of directors meeting in which the transaction is first discussed. If the transaction is an extraordinary transaction, the office holder’s duty to disclose also applies to a personal interest of a relative of the office holder.

Under the Companies law, an extraordinary transaction is a transaction:

- Other than in the ordinary course of business;
- Not on market terms; or
- That is likely to have a material impact on the company's profitability, assets or liabilities.

Once an office holder complies with the above disclosure requirement, the board of directors may approve a transaction between the company and an office holder, or a third party in which an office holder has a personal interest unless the articles of association provide otherwise. Nevertheless, a transaction that is adverse to the company's interest may not be approved.

If the transaction is an extraordinary transaction, approval is required of both the audit committee and the board of directors, in that order. Under specific circumstances, shareholder approval may also be required. A director who has a personal interest in a matter which is considered at a meeting of the board of directors or the audit committee may not be present at this meeting or vote on this matter, unless a majority of the members of the board of directors or the audit committee, as the case may be, has a personal interest in the matter. If a majority of members of the board of directors have a personal interest therein, shareholder approval is also required.

Under the Companies Law, all arrangements as to compensation of directors in public companies such as ours generally require the approvals of the audit committee, the board of directors and the shareholders, in that order.

Disclosure of Personal Interests of a Controlling Shareholder

Under the Companies Law, the disclosure requirements which apply to an office holder also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder that owns 25% or more of the voting power in the company, if no other shareholder owns more than 50% of the voting power in the company, but excluding a shareholder whose power derives solely from his or her position on the board of directors or any other position with the company. Extraordinary transactions of a public company with a controlling shareholder or in which a controlling shareholder or with a third party has a personal interest, and the terms of engagement of a controlling shareholder as an office holder or employee, require the approval of the audit committee, the board of directors and the shareholders of the company in that order. The shareholder approval must be by a majority of the shares voted on the matter, provided that either:

- At least one-third of the shares of shareholders who have no personal interest in the transaction, and who are present and voting (in person, by proxy or by written ballot) vote in favor thereof; or
- The shareholders who have no personal interest in the transaction who vote against the transaction do not represent more than one percent of the voting power in the company.

Shareholders generally have the right to examine any document in a company's possession pertaining to any matter that requires shareholder approval.

General Duties of Shareholders

Under the Companies Law, each shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations toward the Company and other shareholders and to refrain from abusing his power in the Company, such as shareholder votes. Furthermore, specified shareholders have a duty of fairness toward the Company. These shareholders include any controlling shareholder, any shareholder who knows that he/it possesses the power to determine the outcome of a shareholder vote, and any shareholder who, pursuant to the provisions of the articles of association, has the power to appoint or to prevent the appointment of an office holder or any other power toward the Company. However, the Companies Law does not define the substance of this duty of fairness.

Employees

At the time of commencement of employment, our employees in North America generally sign offer letters specifying basic terms and conditions of employment, and our employees in Israel generally, including our executive officers, sign standard written employment agreements, which include confidentiality and non-compete provisions. The employees in our subsidiaries sign employment agreements which differ according to the country in which they are located.

As of December 31, 2006, we had 475 employees worldwide, of whom 229 were based in Israel, 96 were based in the United States and 150 were based in our other subsidiaries and offices. Of these 475 employees, 163 were employed in research and development, 237 were employed in sales, technical support, business development and marketing, and 75 were employed in management, operations and administration. As of December 31, 2005, we had 432 employees worldwide, of whom 191 were based in Israel, 118 were based in the United States and 123 were based in our other subsidiaries and offices, and as of December 31, 2004, we had 361 employees worldwide, of whom 160 were based in Israel, 100 were based in the United States and 101 were based in our other subsidiaries and offices.

We are subject to Israeli labor laws and regulations with respect to our Israeli employees. These laws principally concern matters such as paid annual vacation, paid sick days, length of the workday and work week, minimum wages, pay for overtime, insurance for work-related accidents, severance pay and other conditions of employment.

Furthermore, we and our Israeli employees are subject to provisions of the collective bargaining agreements between the Histadrut, the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialists Association, by order of the Israeli Ministry of Labor and Welfare. These provisions principally concern cost of living increases, recreation pay and other conditions of employment. We provide our employees with benefits and working conditions above the required minimums. Our employees are not represented by a labor union. The employees of our subsidiaries are subject to local labor laws, regulations and/or collective bargaining agreements that vary from country to country.

We consider our relations with our employees to be good and we have never experienced a strike or work stoppage.

Share Ownership

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares by our directors and officers as of June 3, 2007. The percentage of outstanding ordinary shares is based on 19,455,532 ordinary shares outstanding as of June 3, 2007.

| Name | Number of ordinary shares | Percentage of outstanding ordinary shares |
|---|---------------------------|---|
| Yehuda Zisapel | 2,645,727(1) | 13.57% |
| Roy Zisapel | 1,028,841 (2) | 5.18% |
| Meir Moshe | 296,165(3) | 1.51% |
| All directors and executive officers as a group (14 persons) (4)(5) | 4,103,324 | 20.27% |

- (1) Consists of 2,605,727 shares and 40,000 options which are fully vested at the date of this Annual Report.
- (2) Consists of 628,841 shares and 400,000 options which are fully vested or will be vested in the 60 days following the date of this Annual Report. In addition to the position stated in the table, Mr. Roy Zisapel is the beneficiary of a trust that, as of May 2006, the date on which the trust was established by him, held 229,142 ordinary shares. The trust is irrevocable and is scheduled to expire in May 2008. Mr. Zisapel does not control the trust and has limited access to information concerning activities and holdings of the trust. He disclaims beneficial ownership of the shares held in the trust.
- (3) Consists of 86,165 shares and 210,000 options which are fully vested or which will be fully vested within the next 60 days.
- (4) Consists of 3,322,324 shares and 781,000 options which are fully vested or which will be fully vested within the next 60 days.
- (5) Each of the directors and executive officers not separately identified in the above table beneficially own less than 1% of our outstanding ordinary shares (including options held by each such party, and which are vested or shall become vested within 60 days of the date of this Annual Report) and have therefore not been separately disclosed.

Nasdaq Listing Standards

Our Ordinary Shares are currently listed on the Nasdaq Global Market and are thereby subject to the rules and regulations established by Nasdaq and applicable to listed companies. Rule 4350 of the NASDAQ Marketplace Rules imposes various corporate governance requirements on listed securities. Section (a)(1) of Rule 4350 provides that foreign private issuers are required to comply with certain specific requirements of Rule 4350, but, as to the balance of Rule 4350, foreign private issuers may comply with the laws of their home jurisdiction in lieu of the requirements of such sections of Rule 4350.

We have chosen to follow the rules of our home jurisdiction, the Israeli Companies Law, in lieu of the requirement of Section 4350(i)(1)(A) relating to the solicitation of shareholder approval prior to the issuance of designated securities when a stock option or purchase plan is to be established or materially amended. This requirement of Rule 4350 is not required under the Israeli Companies Law.

Key Employee Share Incentive Plan

In June 1997, we adopted our Key Employee Share Incentive Plan. Options granted pursuant to our share option plan are for a term of sixty-two months from the date of the grant of the option. As of December 31, 2006, 8,087,071 ordinary shares have been reserved for option grants under the plan, of which we have granted options to purchase 7,391,802 ordinary shares, at a weighted average exercise price of \$11.04 per ordinary share. The amount of reserved shares includes an increase of the number of shares reserved under the plan in an amount of 3% of our issued and outstanding stock approved by the Board of Directors meeting held on July 13, 2006. We intend to grant further options under our share option plan to our executive officers and employees. In light of the new accounting standard SFAS No. 123(R), however, we may amend our option plan, reduce the number of options granted to the employees or suggest alternative compensation schemes.

Our share option plan is administered by the Compensation Committee of our Board of Directors. Pursuant to the plan, the committee has the authority to determine (subject to applicable law), or advise the Board of Directors, in its discretion:

- The persons to whom options are granted;
- The number of shares underlying each options award;
- The time or times at which the award shall be made;
- The exercise price, vesting schedule and conditions pursuant to which the options are exercisable; and
- Any other matter necessary or desirable for the administration of the plan.

Pursuant to our share option plan, all options, or shares issued upon exercise of options, are held in trust and registered in the name of a trustee which was selected by the share incentive committee. The trustee will not release the options or ordinary shares to the option holder before the options are vested (unless pre-approved by us) or before the lapse of a longer period if so required under local tax laws and regulations. Our Board of Directors may terminate or amend our share option plan, provided that any action by our Board of Directors which will alter or impair the rights of an option holder requires the prior consent of that option holder.

In order to comply with the provisions of Section 102 of the Israeli Income Tax Ordinance [New Version], 1961 (the “Tax Ordinance”), which was amended in January 2003, on March 5, 2003, our Board of Directors adopted an addendum to our share option plan with respect to options granted on or after January 1, 2003 to grantees who are residents of Israel. This addendum does not add to nor modify our share option plan in respect to grantees that are not residents of Israel.

Directors and Consultants Option Plan

On February 18, 2000 we adopted a Directors and Consultants Option Plan. Options granted pursuant to our share option plan are for a term of sixty-two months from the date of the grant of the option. The terms of the Directors and Consultants Option Plan are similar to the terms of the Key Employee Share Incentive Plan. The shares reserved for the Key Employee Share Incentive Plan provide for the Directors and Consultants Option Plan as well, and the same Compensation Committee administers the two plans. The Compensation Committee may not grant options to members of the Committee or to a shareholder of over 10% of our issued and outstanding shares. The shares reserved for the 1997 Key Employee Share Incentive Plan, are also used for option grants under the Directors and Consultants Option Plan.

ITEM 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of June 3, 2007, by each person or entity known to own beneficially more than 5% of our outstanding ordinary shares based on information provided to us by the holders or disclosed in public filings with the Securities and Exchange Commission. The voting rights of all major shareholders are the same as for all other shareholders.

| Name | Number of ordinary shares | Percentage of outstanding ordinary shares |
|-------------------------|---------------------------|---|
| Yehuda Zisapel (1) | 2,645,727 | 13.57% |
| Roy Zisapel (2) | 1,028,841 | 5.18% |
| P.A.W. Capital Corp.(3) | 1,011,400 | 5.12% |
| FMR Corp. (4) | 1,637,300 | 8.42% |

(1) Includes 295,000 ordinary shares owned of record by Carm-AD Ltd., an Israeli company, which is controlled by Yehuda Zisapel, and 40,000 options which are fully vested at the date of this Annual Report.

(2) Includes 628, 841 shares and 400,000 options which are fully vested or will be vested in the 60 days following the date of this Annual Report. In addition to the position stated in the table, Mr. Roy Zisapel is the beneficiary of a trust that, as of May 2006, the date on which the trust was established by him, held 229,142 ordinary shares. The trust is irrevocable and is scheduled to expire in May 2008. Mr. Zisapel does not control the trust and has limited access to information concerning activities and holdings of the trust. He disclaims beneficial ownership of the shares held in the trust.

(3) Includes 1,000,400 shares beneficially owned by P.A.W., Capital Corp., a Delaware corporation, and Peter W. Write, President of P.A.W. Capital Corp.

(4) Includes shares beneficially owned by Fidelity Management & Research Company, a wholly owned subsidiary of FMR Corp., as a result of acting as an investment advisor to various investment companies registered under Section 8 of the Investment Company Act of 1940, shares beneficially owned by Fidelity Management Trust Company, a wholly owned subsidiary of FMR Corp., and a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, as a result of its serving as an investment manager of institutional accounts, and shares are held by Fidelity International Limited, an investment advisor to various investment companies, and various foreign-based subsidiaries. This information is based on FMR’s notification to the Company’s secretary dated April 26, 2007.

Major Shareholders Voting Rights

Our major shareholders do not have different voting rights.

Record Holders

Based on a review of the information provided to us by our transfer agent, as of May 31, 2007, there were 44 holders of record of our ordinary shares, of which 22 record holders, holding approximately 14% of our ordinary shares, had registered addresses in Israel. These numbers are not representative of the number of beneficial holders of our shares nor is it representative of where such beneficial holders reside.

B. Related Party Transactions

We have entered into a number of agreements with certain companies, of which Yehuda and Zohar Zisapel are co-founders, directors and/or principal stockholders, collectively known as the RAD-Bynet Group. Of these agreements, the lease for our headquarters in Tel Aviv is material to our operations. We believe that the terms of the transactions in which we have entered with members of the RAD-Bynet Group are not different in any material respect from terms we could obtain from unaffiliated third parties. The pricing of the transactions were arrived at based on negotiations between the parties. Members of our management reviewed the pricing of the lease agreement, and confirmed that they were not different than that which could have been obtained from unaffiliated third parties. In addition, the Company purchases different services from third parties at special rates offered to the RAD-Bynet Group, such as car leases, maintenance, insurance and communication services. In the event that we cease to be a member of the RAD-Bynet Group, we may not be able to obtain the current rates for such services. We believe, however, that due to the affiliation between us and the RAD-Bynet Group, we have greater flexibility in certain terms than might be available from unaffiliated third parties on similar issues. In the event that the transaction with members of the RAD-Bynet Group is terminated and we enter into similar transactions with unaffiliated third parties, that flexibility may not be available to us.

All transactions and arrangements with affiliated parties, including other members of the RAD-Bynet Group, require approval by the Audit Committee and our Board of Directors and may, in certain circumstances, require approval by our shareholders.

Services and Equipment Furnished by members of the RAD-Bynet Group

Some companies which are also members of the RAD-Bynet Group provide us with marketing, administrative and network management services, and we reimburse each for its costs in providing such services. The aggregate amount of the reimbursements to such companies amounted to approximately \$441,000 in 2006. During 2006 we purchased from members of the RAD-Bynet Group computer and testing equipment in the amount of \$939,000.

Lease of Property

We lease the office space for our headquarters and principal R&D, administrative, finance and marketing and sales operations from two private companies owned by Messrs. Zohar Zisapel and Yehuda Zisapel. The facilities are located in a five-story building in Tel Aviv, Israel, and consist of approximately 48,420 square feet, plus storage and parking space. The monthly rent amounts to approximately \$38,240. The lease expires in October 2007. We also lease from the same affiliated companies office space in a nearby location of which approximately 2,590 square feet for monthly rent of \$2,892. We entered into an agreement with RAD Data Communications, Inc., a Company controlled by Yehuda and Zohar Zisapel, pursuant to which we will lease approximately 12,382 square feet in Mahwah, New Jersey, consisting of 8,121 square feet of office space and 4,261 square feet of warehouse space, in consideration for monthly rent of approximately \$17,000 (including taxes, electricity and management fees). The lease expires on April 20, 2010.

Distribution Agreement

Bynet Data Communications Ltd., a member of the RAD-Bynet Group, distributes our products in Israel on a non-exclusive basis. We have a written distributor agreement with Bynet Data Communications Ltd., according to which we provide them with discounts similar to the discounts provided to third-party distributors in the region in the ordinary course of business. The total sales to Bynet Data Communications amounted to \$3,656,000 during 2006.

Compensation of Chief Executive Officer

See discussion in Item 6 “Directors, Senior Management and Employees - Directors and Senior Management”.

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. Financial Information

A. Consolidated Statements and other Financial Information

See “Item 18 - Financial Statements”.

A.7. Legal Proceedings

In December 2001, we, our Chairman Yehuda Zisapel, our President, Chief Executive Officer and Director Roy Zisapel and our Chief Financial Officer Meir Moshe (the “Individual Defendants”) and several underwriters in the syndicates for our September 30, 1999 initial public offering and January 24, 2000 secondary offering, were named as defendants in a class action complaint alleging violations of the federal securities laws in the United States District Court, Southern District of New York. The complaint seeks unspecified damages as a result of alleged violations of Section 11 of the Securities Act of 1933 against all the defendants and Section 15 of the Securities Act of 1933 against the Individual Defendants arising from activities purportedly engaged in by the underwriters in connection with our initial public offering and secondary offering. Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's initial public offering and secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. An amended complaint filed on April 19, 2002, which is now the operative complaint, added a claim under Section 10(b) of the Securities Exchange Act of 1934 against the Company and a claim under Section 20(a) of the Securities Exchange Act of 1934 against the Individual Defendants. Plaintiffs allege that the Prospectuses for the Company's initial public offering and secondary offering were false and misleading because they did not disclose these arrangements. The action is being coordinated with approximately three hundred other nearly identical actions filed against other companies before one judge in the U.S. District Court for the Southern District of New York. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Individual Defendants. This dismissal disposed of the Section 15 and 20(a) control person claims without prejudice, since these claims were asserted only against the Individual Defendants. On February 19, 2003, the Court denied the motion to dismiss with respect to the Company. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The underwriter defendants appealed the decision and the Second Circuit vacated the district court’s decision granting class certification in those six cases on December 5, 2006. Plaintiffs filed a petition for rehearing. On April 6, 2007, the Second Circuit denied the petition, but noted that the plaintiffs could ask the district court to certify a more narrow class than the one that was rejected. Plaintiffs have not yet moved to certify a class in the Radware case.

Prior to the Second Circuit’s December 5, 2006 ruling, the Company approved a settlement agreement and related agreements which set forth the terms of a settlement between the Company, the Individual Defendants, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. These agreements were submitted to the Court for approval. The settlement would have provided, among other things, a release of the Company and the Individual Defendants for the conduct alleged to be wrongful in the complaint in exchange for a guarantee from the Company’s insurers regarding recovery from the underwriter defendants and other consideration from the Company regarding its underwriters. In light of the Second Circuit opinion, liaison counsel for the issuers informed the district court that the settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. We cannot predict whether we will be able to negotiate a settlement that complies with the Second Circuit’s mandate. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the matter. If the Company is found liable, we are unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than the Company’s insurance coverage, and whether such damages would have a material impact on our results of operations, cash flows or financial condition in any future period.

The Company’s French subsidiary, Radware France, is a party to two separate litigation proceedings before the Boulogne-Billancourt Employment Tribunal, brought against the subsidiary by two of its former employees claiming damages in connection with their dismissal. The hearings with respect to these matters are scheduled for January 10, 2008 and April 3, 2008, respectively. At this stage without receiving all file submissions we cannot asses the outcome or the risks associated with these two matters but in any event we do not expect them to have a material affect on the Company.

From time to time, we are involved in routine trade litigation. We are not subject to any additional material legal proceedings.

Dividend Distribution Policy

We have never paid and do not intend to pay cash dividends on our ordinary shares in the foreseeable future. Our earnings and other cash resources will be used to continue the development and expansion of our business. Any future dividend policy will be determined by our Board of Directors and will be based upon conditions then existing, including our results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions.

B. Significant Changes

Except as otherwise disclosed in this annual report, we are not aware of any significant changes since the date of the audited consolidated financial statements included in this annual report.

ITEM 9. The Listing

A. Listing Details

Our ordinary shares have been listed for quotation on the Nasdaq Global Market as of September 30, 1999, and, since May 12, 2004 on the Tel Aviv Stock Exchange, or TASE, both under the symbol “RDWR”.

The following table sets forth the high and low closing price for our ordinary shares as reported by the Nasdaq Global Market and TASE for the periods indicated:

| Annual High and Low | Nasdaq Global Market | | Tel Aviv Stock Exchange | |
|------------------------|----------------------|----------|-------------------------|-----------|
| | High | Low | High | Low |
| 2002 | \$ 12.95 | \$ 6.5 | -- | -- |
| 2003 | \$ 28.54 | \$ 7.97 | -- | -- |
| 2004 | \$ 32.42 | \$ 14.94 | NIS118.00 | NIS 69.60 |
| Quarterly High and Low | | | | |
| 2005 | | | | |
| First Quarter | \$ 26.56 | \$ 22.24 | NIS 115.00 | NIS 98.07 |
| Second Quarter | \$ 24.65 | \$ 18.08 | NIS 108.90 | NIS 82.97 |
| Third Quarter | \$ 19.49 | \$ 15.19 | NIS 90.27 | NIS 67.93 |
| Fourth Quarter | \$ 19.43 | \$ 17.03 | NIS 89.41 | NIS 79.29 |
| ANNUAL | \$ 26.56 | \$ 15.19 | NIS 115.00 | NIS 67.93 |
| 2006 | | | | |
| First Quarter | \$ 21.49 | \$ 17.63 | NIS 101.10 | NIS 84.49 |
| Second Quarter | \$ 16.60 | \$ 12.84 | NIS 82.22 | NIS 58.21 |
| Third Quarter | \$ 14.40 | \$ 11.44 | NIS 63.00 | NIS 50.43 |
| Fourth Quarter | \$ 16.14 | \$ 13.60 | NIS 67.13 | NIS 59.13 |
| ANNUAL | \$ 21.49 | \$ 11.44 | NIS 101.10 | NIS 50.43 |

Most recent six months

| | | | | | |
|----------|----|-------|----|-------|---------------------|
| 2007 | | | | | |
| June* | \$ | 13.35 | \$ | 13.29 | NIS 54.81 NIS 53.97 |
| May | \$ | 13.30 | \$ | 12.31 | NIS 54.05 NIS 49.73 |
| April | \$ | 13.11 | \$ | 12.87 | NIS 56.64 NIS 51.71 |
| March | \$ | 14.45 | \$ | 13.46 | NIS 61.76 NIS 56.63 |
| February | \$ | 14.63 | \$ | 13.00 | NIS 61.53 NIS 55.24 |
| January | \$ | 15.62 | \$ | 12.84 | NIS 67.97 NIS 55.30 |
| 2006 | | | | | |
| December | \$ | 16.14 | \$ | 15.35 | NIS 67.13 NIS 63.64 |

*Through June 4, 2007

B. Plan of Distribution

Not applicable.

C. Markets

Our ordinary shares are listed for quotation on the Nasdaq Global Market under the symbol “RDWR” and on the Tel Aviv Stock Exchange.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. Additional information

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set out below is a description of certain provisions of our Memorandum of Association and Articles of Association, and of the Israeli Companies Law related to such provisions. This description is only a summary and does not purport to be complete and is qualified by reference to the full text of the Memorandum and Articles which are incorporated by reference to exhibits to this Annual Report and by Israeli law.

We were first registered under Israeli law on May 16, 1996 as a private company, and on November 18, 1999 became a public company. Our registration number with the Israeli registrar of companies is 52-004437-1.

Objects and Purposes

Pursuant to our articles of association, our object is to engage, directly or indirectly, in any lawful undertaking or business whatsoever, including, without limitation, as stipulated in our Memorandum of Association, which was filed with the Israeli registrar of companies.

Shares; Transfer of Shares

Our registered capital is divided into 30,000,000 ordinary shares of nominal (par) value NIS 0.10 each. There are no other classes of shares. All of our outstanding shares are fully paid and non-assessable. The shares do not entitle their holders to preemptive rights and fully paid ordinary shares may be freely transferred pursuant to our articles of association unless such transfer is restricted or prohibited by another instrument.

Dividend and Liquidation Rights

Dividends on our ordinary shares may be paid only out of profits and other surplus, as defined in the Companies Law, as of the end of the most recent financial statements or as accrued over a period of two years, whichever is higher. Our Board of Directors is authorized to declare dividends, provided that there is no reasonable concern that payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due, and provided further that our shareholders approved the final dividend declared by the Board of Directors, in an amount not to exceed the Board of Directors’ recommendation. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to their respective holdings. This liquidation right may be affected by the grant of preferential dividends or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

Voting, Shareholders' Meetings and Resolutions

We have two types of general shareholder meetings: the annual general meeting and the extraordinary general meeting. An annual general meeting must be held once in every calendar year, but not more than 15 months after the last annual general meeting. The Board of Directors may convene an extraordinary general meeting whenever it thinks fit, and is obliged to do so upon the request of any of: two directors or one fourth of the serving directors; one or more shareholders who have at least 5% of the issued share capital and at least 1% of the voting rights; or one or more shareholders who have at least 5% of the voting rights.

Under the Companies Law, shareholder meetings generally require prior notice of not less than 21 days. The Companies Law also provides that the record date for the participation of shareholders of a company whose shares are traded or registered outside of Israel such as us may generally be no more than 40 but no less than 28 days prior to the meeting, provided that notice for said meeting is given prior to the record date. A shareholder may vote in person or by proxy, or, if the shareholder is a corporate body, by its representative.

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. A shareholder may only vote the shares for which all calls have been paid, except in separate general meetings of a particular class.

These voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future. The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or by proxy who hold or represent between them at least 35% of the outstanding voting shares unless otherwise required by applicable rules. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the Chairman may designate with the consent of a majority of the voting power represented at the meeting and voting on the matter adjourned. At such reconvened meeting the required quorum consists of any two members present in person or by proxy.

Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority of the shares present, in person or by proxy, and voting on the matter. However, our articles of association require approval of at least 75% of the shares present and voting to increase our share capital or to change its structure, grant any special rights to the holders of a class of shares with preferential rights or change such rights previously granted or remove directors from office.

Subject to the Companies Law, a resolution in writing signed by the holders of all of our ordinary shares entitled to vote at a meeting of shareholders or to which all such shareholders have given their written consent will be sufficient to adopt the resolution in lieu of a meeting.

General Duties of Shareholders

Under the Companies Law, each and every shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations towards the company and other shareholders and refrain from abusing his power in the company, such as in voting in the general meeting of shareholders on the following matters:

- Any amendment to the articles of association;
- An increase of the company's authorized share capital;
- A merger; or
- Approval of certain related party transactions and actions which require shareholder approval pursuant to the Companies Law.

In addition, each and every shareholder has the general duty to refrain from depriving rights of other shareholders.

Furthermore, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the articles of association, has the power to appoint or to prevent the appointment of an office holder in the company or any other power toward the company is under a duty to act in fairness towards the company. The Companies Law does not describe the substance of this duty of fairness. These various shareholder duties may restrict the ability of a shareholder to act in what the shareholder perceives to be its own best interests.

Restrictions on Non-Israeli Residents

The ownership or voting of our ordinary shares by non-residents of Israel, except with respect to citizens of countries which are in a state of war with Israel, is not restricted in any way by our Memorandum of Association or Articles of Association or by the laws of the State of Israel.

Mergers and Acquisitions under Israeli Law

There are no specific provisions of our memorandum or articles of association that would have an effect of delaying, deferring or preventing a change in control of us or that would operate only with respect to a merger, acquisition or corporate restructuring involving us (or any of our subsidiaries). However, certain provisions of the Companies Law may have such effect.

The Israeli Companies Law includes provisions that allow a merger transaction and requires that each company that is party to a merger approve the transaction by its board of directors and a vote of the majority of its shares, voting on the proposed merger at a shareholders’ meeting. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if shares, representing a majority of the voting power present at the shareholders meeting and which are not held by the other party to the merger (or by any person who holds 25% or more of the voting power of the right to appoint 25% or more of the directors of the other party), vote against the merger. Upon the request of a creditor of either party of the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least (i) 50 days have passed from the time that a proposal of the merger has been filed with the Israeli Registrar of Companies by each merging company and (ii) 30 days have passed since the merger was approved by the shareholders of each merging company.

In addition, provisions of the Companies Law that deal with “arrangements” between a company and its shareholders may be used to effect squeeze-out transactions in which the target company becomes a wholly-owned subsidiary of the acquiror. These provisions generally require that the merger be approved by a majority of the participating shareholders holding at least 75% of the shares voted on the matter. In addition to shareholder approval, court approval of the transaction is required, which entails further delay. The Companies Law also provides for a merger between Israeli companies, after completion of the above procedure for an “arrangement” transaction and court approval of the merger.

The Companies Law also provides that an acquisition of shares of a public company must be made by means of tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company and there is no 25% or greater shareholder in the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company, unless there is already a 45% or greater shareholder of the company. These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received shareholder approval, (2) was from a 25% or greater shareholder of the company which resulted in the acquirer becoming a 25% or greater shareholder of the company, or (3) was from a 45% or greater shareholder of the company which resulted in the acquirer becoming a 45% or greater shareholder of the company. The tender offer must be extended to all shareholders, but the offeror is not required to purchase more than 5% of the company's outstanding shares, regardless of how many shares are tendered by shareholders. The tender offer may be consummated only if (i) at least 5% of the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to it. The Companies Law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquiror may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares.

Finally, Israeli tax law treats stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does U.S. tax law. For example, Israeli tax law subjects a shareholder who exchanges his ordinary shares for shares in another corporation to taxation on half the shareholder's shares two years following the exchange and on the balance four years thereafter even if the shareholder has not yet sold the new shares.

Modification of Class Rights

Our articles of association provide that the rights attached to any class (unless otherwise provided by the terms of such class), such as voting, rights to dividends and the like, may be varied by written consent of holders of seventy-five percent of the issued shares of that class, or by adoption by the holders of seventy-five percent of the shares of that class at a separate class meeting. Subject thereto, the conditions imposed by our articles of association governing changes in the rights of any class of shares, are no more stringent than is required by Israeli law.

Board of Directors

According to the Companies Law and our articles of association, the management of our business is vested in our Board of Directors. Our articles of association provide that the Board of Directors shall consist of not less than five and not more than nine directors as shall be determined by our shareholders. (in October 2006 our shareholders fixed the maximum size of our Board of Directors at nine members.) In accordance with our articles of association, our Board of Directors (other than our external directors) is divided into three classes with each class serving until the third annual meeting following their election, as more fully described in “Item 6- Directors, Senior Management and Employees - Board Practices - Staggered Board.”There is no requirement under our articles or Israeli law for directors to retire on attaining a specific age. Our articles do not require directors to hold our ordinary shares to qualify for election.

The Board of Directors may exercise all such powers and may take all such actions that are not specifically granted to our shareholders. As part of its powers, our Board of Directors may cause the Company to borrow or secure payment of any sum or sums of money for the purposes of the Company, at such times and upon such terms and conditions as it thinks fit, including the grants of security interests on all or any part of the property of the Company. In addition, the Companies Law requires that transactions between a company and its office holders (which term includes directors) or that benefit its office holders, including arrangements as to the compensation of office holders, be approved as provided for in the Companies Law and the Company's articles of association, as more fully described in Item 6C under “Approval of Specified Related Party Transactions Under Israeli Law”.

A resolution proposed at any meeting of the Board of Directors shall be deemed adopted if approved by a majority of the directors present and voting on the matter.

Exculpation, Insurance and Indemnification

Exculpation of Office Holders

Under the Companies Law, an Israeli company may not exempt an office holder from liability for a breach of his or her duty of loyalty, but may exempt in advance an office holder from his or her liability to the company, in whole or in part, for a breach of his duty of care (except in connection with distributions), provided that the articles of association of the company allow it to do so. Our articles of association allow us to exempt our office holders to the maximum extent permitted by law.

Insurance of Office Holders

Our articles of association provide that, subject to the provisions of the Companies Law, we may enter into a contract for the insurance of the liability of any of our office holders, with respect to an act performed in the capacity of an office holder for:

- A breach of his or her duty of care to us or to another person;
- A breach of his or her duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice our interests; or
- A financial liability imposed upon him or her in favor of another person.

Exculpation and Indemnification of Office Holders

Under the Companies Law, we may indemnify any of our office holders against the following obligations and expenses imposed on the office holder with respect to an act performed in the capacity of an office holder:

- A financial liability incurred by, or imposed on him or her in favor of another person by a court judgment, including a settlement or an arbitration award approved by the court. Such indemnification may be approved (i) after the liability has been incurred or (ii) in advance, provided that our undertaking to indemnify is limited to events that our Board of Directors believes are foreseeable in light of our actual operations at the time of providing the undertaking and to a sum or criterion that our Board of Directors determines to be reasonable under the circumstances;
- Reasonable litigation expenses, including attorney’s fees, expended by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against him or her or the imposition of any financial liability in lieu of criminal proceedings other than with respect to a criminal offense that does not require proof of criminal intent; and

- Reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him or her by a court in connection with proceedings we institute against him or her or instituted on our behalf or by another person, a criminal indictment from which he or she was acquitted, or a criminal indictment in which he or she was convicted for a criminal offense that does not require proof of criminal intent.

Limitations on Insurance and Indemnification

The Companies Law provides that a company may not indemnify an office holder, or enter into an insurance contract which would provide coverage for any monetary liability incurred as a result of any of the following:

- A breach by the office holder of his or her duty of loyalty unless, with respect to indemnification or insurance coverage, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- A breach by the office holder of his or her duty of care if the breach was done intentionally or recklessly unless the breach was done negligently;
- Any act or omission done with the intent to derive an illegal personal benefit; or
- Any fine levied against the office holder.

In addition, under the Companies Law, indemnification of, and procurement of insurance coverage for, our office holders must be approved by our Audit Committee and our Board of Directors and, if the beneficiary is a director, by our shareholders.

We currently hold directors and officers liability insurance for the benefit of our office holders. In addition, we provide our directors and officers indemnification pursuant to the terms of a Letter of Indemnification substantially in the form approved by our shareholders (See Exhibit 4.4 of our amended annual report on Form 20-F/A for the year ending December 31, 2005 filed with the Securities and Exchange Commission on July 6, 2006, for the form of such letter.)

C. Material Contracts

On April 25, 2007 we entered into an agreement and plan of merger with Covelight, pursuant to which we purchased Covelight for a consideration of up to \$16 million, consisting of \$7.5 million paid at closing and up to \$8.5 million to be paid in 12 months from closing based on achieving certain sales revenues from the sales of Covelight products, with the maximum amount of \$8.5 million being paid if the sales of Covelight’s products during the 12 months ending on March 31, 2008 are no less than \$8 million. The agreement included representations, warranties and indemnification obligations of Covelight’s shareholders with respect to Covelight’s financial statements, employees, material agreements, intellectual property and additional business parameters.

For a summary of additional material contracts, see “Item 5 - Operating and Financial Review and Prospects - General - Business Combinations” and “Item 7 - Major Shareholders and Related Party Transactions - Related Party Transactions - Lease of Property”.

D. Exchange Controls

There are currently no Israeli currency control restrictions on payments of dividends or other distributions with respect to our ordinary shares or the proceeds from the sale of the shares, except for the obligation of Israeli residents to file reports with the Bank of Israel regarding certain transactions. However, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time.

E. Taxation

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

Israeli Tax Considerations

The following is a summary of the current tax structure applicable to companies incorporated in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to purchasers of our ordinary shares and Israeli government programs benefiting us. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the Israel tax authorities or courts. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Structure

Generally, Israeli companies are subject to “Corporate Tax” on their taxable income at the rate of 31% for the 2006 tax year. . Following an amendment to the Tax Ordinance), which came into effect on January 1, 2006, the Corporate Tax rate is scheduled to decrease as follows: in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. Israeli companies are generally subject to Capital Gains Tax at a rate of 25% for capital gains (other than gains deriving from the sale of listed securities) derived after January 1, 2003. However, the effective tax rate payable by a company which derives income from an approved enterprise (as further discussed below) may be considerably less.

Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959

The law before the amendment of 2005

The Law for the Encouragement of Capital Investments, 1959, as in effect prior to April 1, 2005 (the “Investments Law”), provided that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an approved enterprise. The Investment Center based its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program.

The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise’s ordinary course of business. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a consumer price index linkage adjustment and interest.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income (after the commencement of production), and is limited to twelve years from commencement of production or 14 years from the date of approval, whichever is earlier (the “Years Limitation”).

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company’s undistributed income derived from the approved enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The Years Limitation does not apply to the exemption period. A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not elected the alternative package of benefits, generally 10%-25%, depending on the percentage of the company’s ordinary shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax at source.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors’ company. A foreign investors’ company is a company which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors’ company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefits period. The tax rate for the remainder of the benefits period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company’s effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year’s profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

The Investment Center has granted us an approval to establish an approved enterprise program under the Investments Law, at our facilities in Tel Aviv and Jerusalem.

The current benefits for an approved enterprise program in Jerusalem provide that income derived from the approved enterprise program allocated to the approved enterprise in Jerusalem is tax exempt for ten years commencing with the year in which the approved enterprise first generates taxable income and will be taxed at a reduced company tax rate of up to 25% (rather than the regular corporate tax rate) in the following years.

The current benefits for an approved enterprise program in Tel Aviv provide that income derived from the approved enterprise program and allocated to our Tel Aviv facility will be tax exempt for a period of two years and will be subject to a reduced tax rate, depending on the level of foreign investment, for an additional period of five to eight years.

As mentioned above, the Investment Center’s approval is for establishing an approved enterprise program in both Tel Aviv and Jerusalem. The approval provides for the allocation of tax benefits between our facilities in Tel Aviv and Jerusalem such that the income derived from the approved enterprise program shall be allocated pro-rata between the aforementioned facilities based on the expenses borne by each facility. However, since all our manufacturing and part of our research and development facilities are located in Jerusalem, the Investment Center determined the method of allocation of tax benefits between our facilities in Jerusalem and Tel Aviv as follows: The method of allocation of the tax benefits between our facilities in Tel Aviv and Jerusalem will be based on the number of research and development employees in each of the facilities, provided, however that the average salary for such employees in our Jerusalem facility will not be less than 85% of the average salary of such employees in our Tel Aviv facility. In the years that such condition is not fulfilled, the method of allocation will be as follows: (i) 50% of our income will be allocated between our Jerusalem facility and our Tel Aviv facility, pro-rata according to the number of employees engaged in research and development or manufacturing activities in each facility; and (ii) 50% of our income will be allocated between our Jerusalem facility and our Tel Aviv facility, pro-rata according to the salaries paid to the employees engaged in research and development or manufacturing activities in each facility. The Israeli government may reduce or eliminate tax benefits available to approved enterprise programs in the future. We cannot assure you that our approved program and the benefits thereunder shall continue in the future at its current level or at any level. See “Item 3 - Key Information - Risks Related to Operations In Israel.”

In 2004, the Company began to utilize the above mentioned tax benefits, and they are scheduled to gradually expire through 2013. As of December 31, 2006, retained earnings included approximately \$25,000,000 in tax-exempt income earned by the Company's "Approved Enterprise". The Company has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

If the retained tax-exempt income is distributed, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits (currently between 10% - 25%) and an income tax liability of up to \$6,250,000 would be incurred.

Income from sources other than the "Approved Enterprise" will be subject to the tax at the regular rate.

During 2004, the Company's production facilities in Israel (Tel Aviv and Jerusalem) were granted an expansion program to its Approved Enterprise status by the Investment Center. The Company applied for an amendment to this expansion program, according to which it requested an enlargement to this expansion program, neutralization of certain assets and an approval that the benefits period from such expansion program will commence in 2006. The Investment Center granted temporary approval for the year 2006.

The 2005 Amendment to the Investments Law

An amendment to the Investments Law, which was published on April 1, 2005 (the "Amendment"), has changed certain provisions of the Law. As a result of the Amendment, a company is no longer obliged to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions, and therefore generally there is no need to apply to the Investment Center for this purpose. (Approved Enterprise status remains mandatory for companies seeking grants.) Rather, the Company may claim the tax benefits offered by the Investments Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (referred to as a "Benefited Enterprise"). In order to receive the tax benefits, the Amendment states that the company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise (the "Year of Election"). Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the commencement year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

- Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%). The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and

- A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is Abundant in Foreign Investment (as defined in the Investments Law) is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The Amendment changes the definition of “foreign investment” in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company’s outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition are retroactive from 2003.

The Amendment will apply to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received approval from the Investment Center on or prior to December 31, 2004, in which case the Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investments Law as they were on the date of such approval.

Should we elect to utilize tax benefits under the Amendment to the law, any such tax exempt profits might be subject to future taxation on the corporate level upon distribution to shareholders by a way of dividend or liquidation. Accordingly, we may be required to recognize deferred tax liability with respect to such tax exempt profits.

A substantial portion of our taxable operating income is derived from our approved enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program. There is no assurance that our Jerusalem facility and Tel Aviv facility will continue to enjoy such status in the future.

Tax Benefits for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

Tax Benefits Under the Law for the Encouragement of Industry (Taxes), 1969

Under the Law for the Encouragement of Industry (Taxes), 1969 (the “Industry Encouragement Law”), Industrial Companies are entitled to the following preferred corporate tax benefits, among others:

- Deduction of purchases of know-how and patents over an eight-year period for tax purposes;
- Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies;

- Accelerated depreciation rates on equipment and buildings; and
- Deductions over a three-year period of expenses involved with the issuance and listing of shares on a stock market.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the Industry Encouragement Law, an “Industrial Company” is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an “Industrial Enterprise” owned by it. An “Industrial Enterprise” is defined as an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. No assurance can be given that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Special Provisions Relating to Taxation Under Inflationary Conditions

Under the Income Tax (Inflationary Adjustments) Law, of 1985, or the Adjustments Law, results for tax purposes are measured in real terms, in accordance with the changes in the Israeli Consumer Price Index (“Israeli CPI”). Accordingly, until 2002, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. Commencing in taxable year 2003, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Such an election obligates the Company for three years. Accordingly, commencing taxable year 2003, results for tax purposes are measured in terms of earnings in dollar. We have submitted a request to the Israeli tax authorities to extend the effect of the above regulations on our company for 2006.

Capital Gains Tax on Sales of Our Ordinary Shares

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder’s country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain which is equivalent to the increase of the relevant asset’s purchase price which is attributable to the increase in the Israeli consumer price index or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Generally, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a “significant shareholder” at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 25%. Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Adjustments Law (or certain regulations) as of August 10, 2005, in which case the applicable tax rate is 25%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided however that such capital gains are not derived from a permanent establishment in Israel, such shareholders are not subject to the Adjustments Law, and such shareholders did not acquire their shares prior to an initial public offering. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the Convention Between the government of the United States of America and the government of Israel with Respect to Taxes on Income, as amended (the “U.S.-Israel Tax Treaty”), the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if (i) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

Taxation of Dividends paid to Non-Resident Holders of Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends. On distributions of dividends other than bonus shares, or stock dividends, income tax is withheld at the source at the rate of 20%, or 25% for a shareholder that is considered a “significant shareholder” at any time during the 12-month period preceding such distribution, unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence. However, under the Investments Law, dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15%.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 25%. However, dividends not generated by an Approved Enterprise (or Benefited Enterprise) paid to a U.S. corporation holding at least 10% of our issued voting power during the part of the tax year which precedes the date of payment of the dividend and during the whole of its prior tax year, are generally taxed at a rate of 12.5%. Dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15% under the U.S.-Israel Tax Treaty.

For information with respect to the applicability of Israeli capital gains taxes on the sale of ordinary shares by United States residents, see above “The 2005 Amendment to the Investments Law — Capital Gains Tax on Sales of Our Ordinary Shares.”

United States Federal Income Tax Considerations

Subject to the limitations described herein, the following discussion summarizes the material United States federal income tax consequences to a U.S. Holder of our ordinary shares. A “U.S. Holder” means a holder of our ordinary shares who is:

- A citizen or resident of the United States for U.S. tax purposes;
- A corporation or partnership (or other entity taxable as a corporation or partnership for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States or any political subdivision thereof;

- An estate, the income of which is subject to United States federal income tax regardless of its source; or
- A trust (i) if, in general a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions, or (ii) that has in effect a valid election under applicable U.S. Treasury regulations to be treated as a U.S. person.

This discussion considers only U.S. Holders that will own their ordinary shares as capital assets and does not purport to be a comprehensive description of all of the tax considerations that may be relevant to each person’s decision to purchase our ordinary shares. Material aspects of U.S. federal income taxation relevant to a holder of our ordinary shares that is not a U.S. Holder (a “Non-U.S. Holder”) are also discussed below.

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the “Code”), current and proposed Treasury regulations promulgated thereunder, and administrative and judicial decisions as of the date hereof, all of which are subject to change, possibly on a retroactive basis. This discussion does not address all aspects of United States federal income taxation that may be relevant to any particular U.S. Holder in light of such holder’s individual circumstances. In particular, this discussion does not address the potential application of the alternative minimum tax or United States federal income tax consequences to shareholders that are subject to special treatment, including holders that:

- Are broker-dealers or insurance companies;
- Have elected mark-to-market accounting;
- Are tax-exempt organizations or retirement plans;
- Are financial institutions or “financial services entities”;
- Hold their shares as part of a straddle, “hedge” or “conversion transaction” with other investments;
- Acquired their shares upon the exercise of employee stock options or otherwise as compensation;
- Are, or hold their shares through, partnerships or other pass-through entities;
- Own directly, indirectly or by attribution at least 10% of our voting power; or
- Have a functional currency that is not the U.S. dollar.

In addition, this discussion does not address any aspect of state, local or non-United States tax laws or the possible application of United States federal gift or estate tax.

Each holder of our ordinary shares is advised to consult such person’s own tax advisor with respect to the specific tax consequences to such person of purchasing, holding or disposing of our ordinary shares, including the applicability and effect of federal, state, local and foreign income tax and other tax laws in such person’s particular circumstances.

Taxation of Ordinary Shares

Taxation of Dividends Paid On Ordinary Shares. Subject to the discussion below under “Passive Foreign Investment Company Status”, a U.S. Holder will be required to include in gross income as dividend income the amount of any distribution paid on our ordinary shares, including any Israeli taxes withheld from the amount paid, on the date the distribution is received to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for United States federal income tax purposes. Distributions in excess of such earnings and profits will be applied against and will reduce the U.S. Holder’s basis in our ordinary shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of our ordinary shares. The dividend portion of such distributions generally will not qualify for the dividends received deduction available to corporations.

Dividends that are received by non-corporate U.S. Holders will be taxed at the rate applicable to long-term capital gains (a maximum rate of 15%), provided that such dividends meet the requirements of “qualified dividend income.” Dividends that fail to meet such requirements, and dividends received by corporate U.S. Holders, are taxed at ordinary income rates. No dividend received by a U.S. Holder will be a qualified dividend (1) if the U.S. Holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. Holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. Holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a “passive foreign investment company” (as such term is defined in the Code) for any year, dividends paid on our ordinary shares in such year or in the following year would not be qualified dividends. The reduced tax rate for qualified dividends is scheduled to expire on December 31, 2010, unless further extended by Congress. In addition, a non-corporate U.S. Holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

Distributions of current or accumulated earnings and profits paid in foreign currency to a U.S. Holder (including any Israeli taxes withheld therefrom) will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate on the day the distribution is received regardless of whether the foreign currency is converted into U.S. dollars. A U.S. Holder that receives a foreign currency distribution and converts the foreign currency into U.S. dollars after the date of receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

U.S. Holders will have the option of claiming the amount of any Israeli income taxes withheld at source either as a deduction from gross income or as a dollar-for-dollar credit against their United States federal income tax liability. Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the Israeli income taxes withheld, but such amount may be claimed as a credit against the individual’s United States federal income tax liability. The amount of foreign income taxes which may be claimed as a credit in any year is subject to complex limitations and restrictions, which must be determined on an individual basis by each U.S. holder. These limitations include, among others, rules which limit foreign tax credits allowable with respect to specific classes of income to the United States federal income taxes otherwise payable with respect to each such class of income. The total amount of allowable foreign tax credits in any year cannot exceed regular U.S. tax liability for the year attributable to foreign source taxable income. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from a dividend received on the ordinary shares if such U.S. Holder has not held the ordinary shares for at least 16 days of the 30-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend, or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16 day holding period. Distributions of current or accumulated earnings and profits will be foreign source passive income for United States foreign tax credit purposes.

Taxation of the Disposition of Ordinary Shares. Subject to the discussion below under “Passive Foreign Investment Company Status,” upon the sale, exchange or other disposition of our ordinary shares, a U.S. Holder will recognize capital gain or loss in an amount equal to the difference between such U.S. Holder’s basis in such ordinary shares, which is usually the cost of such shares, and the amount realized on the disposition. A U.S. Holder that uses the cash method of accounting calculates the U.S. dollar value of the proceeds received on the sale as of the date that the sale settles, while a U.S. Holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the “trade date,” unless such U.S. Holder has elected to use the settlement date to determine its proceeds of sale. Capital gain from the sale, exchange or other disposition of our ordinary shares held more than one year is long-term capital gain, and is eligible for a reduced rate of taxation for individuals. Gains recognized by a U.S. Holder on a sale, exchange or other disposition of our ordinary shares will be treated as United States source income for United States foreign tax credit purposes. A loss recognized by a U.S. Holder on the sale, exchange or other disposition of our ordinary shares is allocated to U.S. source income. The deductibility of a capital loss recognized on the sale, exchange or other disposition of our ordinary shares is subject to limitations. A U.S. Holder that receives foreign currency upon disposition of our ordinary shares and subsequently converts the foreign currency into U.S. dollars or disposes of such foreign currency, will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

Passive Foreign Investment Company Status. We will be a passive foreign investment company (a “PFIC”) if (taking into account certain “look-through” rules with respect to the income and assets of our subsidiaries) either 75 percent or more of our gross income in a taxable year is passive income or the average percentage (by value) of our passive assets during the taxable year is at least 50 percent. If we were a PFIC, each U.S. Holder would (unless it made one of the elections discussed below on a timely basis) be taxable on gain recognized from the disposition of our ordinary shares (including gain deemed recognized if the ordinary shares are used as security for a loan) and upon receipt of certain distributions with respect to our ordinary shares as if such income had been recognized ratably over the U.S. Holder’s holding period for the ordinary shares. The U.S. Holder’s income for the current taxable year would include (as ordinary income) amounts allocated to the current year and to any period prior to the first day of the first taxable year for which we were a PFIC. Tax would also be computed at the highest ordinary income tax rate in effect for each other period to which income is allocated, and an interest charge on the tax as so computed would also apply. Additionally, if we were a PFIC, U.S. Holders who acquire our ordinary shares from decedents (other than nonresident aliens) dying before 2010 would be denied the normally-available step-up in basis for such shares to fair market value at the date of death and, instead, would have a tax basis in such shares equal to the decedent’s basis, if lower. As an alternative to the tax treatment described above, a U.S. Holder could elect to treat us as a “qualified electing fund” (a “QEF”), in which case the U.S. Holder would be taxed currently on its pro rata share of our ordinary earnings and net capital gain (subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge). Special rules apply if a U.S. Holder makes a QEF election after the first year in its holding period in which we are a PFIC. We have agreed to supply U.S. Holders with the information needed to report income and gain under a QEF election if we were a PFIC. As another alternative to the tax treatment described above, a U.S. Holder could elect to mark our ordinary shares to market annually, recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of our shares and the shareholder’s adjusted basis in the shares. Losses would be allowed only to the extent of net mark-to-market gain previously included in income by the U.S. Holder.

As indicated above, we will be a PFIC for any tax year if the average percentage (by value) of our assets held for the production of, or that produce, passive income is at least 50 percent. The Code does not specify how a corporation must determine the fair market value of its assets for this purpose and the issue has not been definitively determined by the courts. The market capitalization approach has generally been used to determine the fair market value of the assets of a publicly traded corporation. The Internal Revenue Service and the courts, however, have accepted other valuation methods in certain valuation contexts. For our 2006 tax year, we have received advice from our tax and valuation consultants to the effect that, based on certain valuation methodologies, the average percentage in 2006 of our passive assets to the fair market value of our total assets was less than 50%. Based on this advice, we reasonably believe that we should not be a PFIC for our tax year ended December 31, 2006. However, there can be no assurance that the Internal Revenue Service will not challenge this treatment.

It is possible that the Internal Revenue Service will attempt to treat us as a PFIC for 2006 or prior years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC in 2007 or in subsequent years.

U.S. Holders who hold our ordinary shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC, subject to certain exceptions for U.S. Holders who made a QEF election or the mark-to-market election.

Although a U.S. Holder normally is not permitted to make a retroactive QEF election for a foreign corporation, a retroactive election may be made for a taxable year of the U.S. Holder (the “retroactive election year”) if the U.S. Holder (i) reasonably believed that, as of the date the QEF election was due, the foreign corporation was not a PFIC for its taxable year that ended during the retroactive election year and (ii) filed a protective statement with respect to the foreign corporation, applicable to the retroactive election year, in which the U.S. Holder described the basis for its reasonable belief and extended the period of limitation on the assessment of taxes determined under Sections 1291 through 1298 of the Code with respect to the foreign corporation (PFIC related taxes) for all taxable years of the shareholder to which the protective statement applies.

U.S. Holders are urged to consult their tax advisors about the PFIC rules, including eligibility for and the manner and advisability of making, the QEF election (or a “protective” QEF election) or the mark-to market election.

Tax Consequences for Non-U.S. Holders of Ordinary Shares

Except as described in “Information Reporting and Back-up Withholding” below, a Non-U.S. Holder of ordinary shares will not be subject to U.S. federal income or withholding tax on the payment of dividends on, and the proceeds from the disposition of, ordinary shares, unless:

- Such item is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States and, in the case of a resident of a country which has a treaty with the United States, such item is attributable to a permanent establishment or, in the case of an individual, a fixed place of business, in the United States;
- The Non-U.S. Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and certain other requirements are met; or
- The Non-U.S. Holder is subject to tax pursuant to the provisions of United States tax law applicable to U.S. expatriates.

Information Reporting and Back-up Withholding

U.S. Holders generally are subject to information reporting requirements with respect to dividends paid in the United States on ordinary shares and proceeds paid from the sale, exchange, redemption or other disposition of ordinary shares. Under the Code, a U.S. Holder may be subject, under certain circumstances, to backup withholding currently at a rate of up to 28% with respect to dividends paid on our ordinary shares and proceeds paid from the sale, exchange, redemption or other disposition of ordinary shares unless the holder provides proof of an applicable exemption or correct taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules.

A holder of ordinary shares who does not provide a correct taxpayer identification number may be subject to penalties imposed by the IRS. Amounts withheld under the backup withholding rules are not an additional tax and may be refunded or credited against the holder’s federal income tax liability, provided the required information is furnished to the IRS.

Non-U.S. Holders generally are not subject to information reporting or back-up withholding with respect to dividends paid on, or the proceeds from the disposition of, ordinary shares, provided that such Non-U.S. Holder provides a taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, applicable to foreign private issuers and fulfill the obligations with respect to such requirements by filing reports with the Securities and Exchange Commission. You may read and copy any document we file with the Securities and Exchange Commission without charge at the Securities and Exchange Commission’s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the Securities and Exchange Commission at such address, at prescribed rates. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. Such materials are also available free of charge at the website of the Securities and Exchange Commission at www.sec.gov.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and “short-swing” profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the Securities and Exchange Commission as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act.

In accordance with Rule 4350(a)(1) of the Rules of Corporate Governance of The Nasdaq Stock Market, Inc., we have received an exemption from the requirement to distribute an annual report to our shareholders prior to our annual meeting of shareholders. The basis for the exemption is that the generally accepted business practice in Israel, where we are incorporated, is not to distribute an annual report to shareholders. We post our Annual Report on Form 20-F on our web site (www.radware.com) as soon as practicable following the filing of the Annual Report on Form 20-F with the Securities and Exchange Commission.

I. Subsidiary Information

Not applicable.

ITEM 11. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk, including movements in interest rates and foreign currency exchange rates. Our primary market risk exposure occurs because we generate most of our revenues in U.S. dollars and incur a portion of our expenses in NIS and in Euro. In 2004 we began selling to some European countries in Euro.

We do not presently engage in any hedging or other transactions intended to manage risks relating to foreign currency exchange rate or interest rate fluctuations. As of December 31, 2006, we did not own any market risk sensitive instruments, except for the following: Approximately 6% of our investment portfolio is invested in a structured note with guaranteed principal and changing interest. An increase in short-term interest rates will negatively affect the income received from this note. We may in the future undertake hedging or other similar transactions or invest in market risk sensitive instruments if our management determines that it is necessary to offset these risks.

Approximately 70% of our investment portfolio is invested in high-rated marketable securities, mainly U.S. government and agency bonds and corporate bonds. Since these investments carry fixed interest rates, interest income over the holding period is not sensitive to changes in interest rates.

ITEM 12. Description of Securities other than Equity Securities

Not applicable.

PART II

ITEM 13. Defaults, Dividend Averages and Delinquencies

Not applicable.

ITEM 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

The effective date of the registration statement (Commission File Number 333-10752) for our initial public offering of our ordinary shares, NIS 0.1 par value, was September 29, 1999. The offering commenced on October 5, 1999, and terminated after the sale of all the securities registered. The managing underwriter of the offering was Salomon Smith Barney. We registered 4,025,000 ordinary shares in the offering, including shares issued pursuant to the exercise of the underwriters' over-allotment option. Of such shares, we sold 3,500,000 ordinary shares at an aggregate offering price of \$63.0 million (\$18.00 per share) and certain selling shareholders sold an aggregate of 525,000 ordinary shares at an aggregate offering price of \$9.45 million (\$18.00 per share). Under the terms of the offering, we incurred underwriting discounts of \$4.41 million. We also incurred estimated expenses of \$1.82 million in connection with the offering. None of the expenses consisted of amounts paid directly or indirectly to any of our directors, officers, general partners or their associates, any persons owing ten percent or more of any class of our equity securities, or any of our affiliates. The net proceeds that we received as a result of the offering were approximately \$56.8 million. None of the use of proceeds consisted of amounts paid directly or indirectly to any of our directors, officers, general partners or their associates, any persons owning ten percent or more of any class of our equity securities, or any of our affiliates.

In January 2000, we raised net proceeds of approximately \$60.0 million in a public offering of our ordinary shares.

The net proceeds of the two offerings are kept in short-term and long-term bank deposits and in marketable securities.

ITEM 15. Controls and Procedures

a. Disclosure Controls and Procedures

The Company's management, with the participation of its chief executive officer and chief financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of December 31, 2006. Based on this evaluation, the Company's chief executive officer and chief financial officer concluded that, as of December 31, 2006, the Company's disclosure controls and procedures were: (1) designed to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the Company's management, including the Company's chief executive officer and chief financial officer, by others within those entities, as appropriate to allow timely decisions regarding required disclosure, particularly during the period in which this report was being prepared; and (2) effective, in that they provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

b. Management’s Annual Report on Internal Control Over Financial Reporting

The Company’s management, under the supervision of our chief executive officer and our chief financial officer, is responsible for establishing and maintaining adequate internal controls over financial reporting for the Company. Based on the criteria for effective internal control over financial reporting established in *Internal Control—Integrated Framework*, which was issued by the Committee of Sponsoring Organizations of the Treadway Commission, management has assessed the Company’s internal control over financial reporting as effective as of December 31, 2006.

c. Attestation Report of the Registered Public Accounting Firm

This annual report does not include an attestation report of the Company’s registered public accounting assessing our internal control over financial reporting. The Company’s management’s report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only the management’s report in this annual report.

d. Changes In Internal Control Over Financial Reporting

No changes in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the year ended December 31, 2006, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

ITEM 16. [Reserved]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Mr. Zohar Gilon, and Dr. Orna Berry, members of our Audit Committee, are Audit Committee financial expert as defined in the applicable regulations, and has determined that such members are “independent” as such term is defined in the Nasdaq listing standards. The education and experience of both Audit Committee financial experts is presented in “Item 6 - Directors, Senior Management and Employees - Directors and Senior Management” and is incorporated herein by reference.

ITEM 16B. CODE OF ETHICS

On February 2, 2004 our Board of Directors adopted our Code of Ethics, a code that applies to all directors, officers and employees of the Company, including our Chief Executive Officer and President, Chief Financial Officer, Director of Finance and Corporate Controller. On January 30, 2005, our Board of Directors modified the Code of Conduct and Ethics. Our Code of Conduct and Ethics (as amended) has been posted on our Internet website, <http://www.radware.com/content/company/investorrelations>.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In the annual meeting held on December 11, 2005 our shareholders re-appointed Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global (“Ernst & Young”), to serve as our independent auditors until the next annual meeting.

Ernst & Young billed the following fees to us for professional services in each of the last two fiscal years:

| | Year Ended December 31, | |
|--------------------|-------------------------|------|
| | 2006 | 2005 |
| | (US\$ in thousands) | |
| Audit Fees | 108 | 108 |
| Audit-Related Fees | 20 | 23 |
| Tax Fees | 7 | 23 |
| All Other Fees | - | - |
| Total | 135 | 154 |

“Audit Fees” are the aggregate fees billed for the audit of our annual financial statements, statutory audits and services that are normally provided in connection with statutory and regulatory filings or engagements.

“Audit-Related Fees” are the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under Audit Fees.

“Tax Fees” are the aggregate fees billed for professional services rendered for tax compliance, tax advice on actual or contemplated transactions and tax planning such as assistance with tax audits and tax advice.

“All Other Fees” are the aggregate fees billed for products and services provided by Ernst & Young other than as described above.

Audit Committee's pre-approval policies and procedures

Our Audit Committee oversees our independent auditors. See also the description in “Item 6- Directors, Senior Management and Employee - Board Practices.” In 2003 our Audit Committee also adopted a policy requiring management to obtain the Committee's approval before engaging our independent auditors to provide any other audit or permitted non-audit services to us or our subsidiaries. Pursuant to this policy, which is designed to assure that such engagements do not impair the independence of our auditors, and which is discussed and approved at the end of each calendar year, the Audit Committee pre-approves annually a catalog of specific audit and non-audit services in the categories Audit Service, Audit-Related Service and Tax Consulting Services that may be performed by our auditors. In addition, the Audit Committee limited the aggregate amount in fees our auditors may receive during the 2006 fiscal year for non-audit services in certain categories, unless pre- approved. Our Director of Legal Affairs and Director of Finance review all individual management requests to engage our independent auditors as a service provider in accordance with this catalog and, if the requested services are permitted pursuant to the catalog, approve the request accordingly. We inform the Audit Committee about these approvals on a quarterly basis. Services that are not included in the catalog require pre-approval by the Audit Committee on a case-by-case basis. Our Audit Committee is not permitted to approve any engagement of our auditors if the services to be performed either fall into a category of services that are not permitted by applicable law or the services would be inconsistent with maintaining the auditors' independence.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

None.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

During 2006 we repurchased our ordinary shares under a share repurchase plan, in an aggregate amount of \$11.1 million, as follows:

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (or Units) (in US\$) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|----------------|--|--|--|--|
| May 22-31 | 121,900 | 14.16 | 121,900 | \$23,274,249 |
| June 1-16 | 237,112 | 13.44 | 237,112 | \$20,088,266 |
| July 26-31 | 106,821 | 11.71 | 106,821 | \$18,837,199 |
| August 1-31 | 324,445 | 12.72 | 324,445 | \$14,711,865 |
| September 5-15 | 56,577 | 13.80 | 56,577 | \$13,931,269 |

PART III

ITEM 17. Financial Statements

We have responded to Item 18 in lieu of this item.

ITEM 18. Financial Statements

The Financial Statements required by this item are found at the end of this Annual Report, beginning on page F-1.

ITEM 19. Exhibits

The exhibits filed with or incorporated into this annual report are listed on the index of exhibits below.

| <u>Exhibit No.</u> | <u>Exhibit</u> |
|--------------------|--|
| 1.1 | Memorandum of Association(A) |
| 1.2 | Articles of Association(B) |
| 1.3 | Amendment to the Articles of Association (C) |
| 4.1 | Lease Agreement for the Company’s Headquarters (B) |
| 4.2 | Lease Agreement for the Company’s Mahwah office (D) |
| 4.3 | Distributor Agreement with Bynet Data Communications Ltd. (D) |
| 4.4 | Form of Directors and Officers Indemnity Deed (D) |
| 4.5 | Asset Purchase Agreement with V-Secure Technologies (U.S.) Inc. (E) |
| 4.6 | Agreement and Plan of Merger by and Between the Company, its subsidiary, Covelight and its stockholders and note-holders |
| 8.1 | List of Subsidiaries |
| 10.1 | Consent of Independent Auditors |
| 12.1 | Certification of the Chief Executive Officer pursuant to Section § 302 of the Sarbanes-Oxley Act of 2002 |
| 12.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 13.1 | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 13.2 | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(A) Incorporated by reference to the Company’s Registration Statement on Form F-1 (File No. 333-10752), filed with the SEC on September 1, 1999.

(B) Incorporated by reference to the Company’s Annual Report on Form 20-F for the year ended December 31, 2000, filed with the SEC on May 11, 2001.

(C) Incorporated by reference to the Company’s Annual Report on Form 20-F for the year ended December 31, 2005, filed with the SEC on April 5, 2006.

(D) Incorporated by reference to the Annual Report on Form 20-F for the year ended December 31, 2001, filed with the SEC on April 5, 2002.

(E) Incorporated by reference to the Annual Report on Form 20-F/A for the year ended December 31, 2005, filed with the SEC on July 6, 2006.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

RADWARE LTD.

By: /s/ Roy Zisapel

Roy Zisapel
Chief Executive Officer

Date: June 5, 2007

RADWARE LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of

RADWARE LTD.

We have audited the accompanying consolidated balance sheets of Radware Ltd. ("the Company") and its subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of operations, statements of changes in shareholders' equity and the consolidated statements of cash flows for each of the three years in the period ended December 31, 2006. 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 the standards of the Public Company Accounting Oversight Board (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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries at December 31, 2005 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2n to the consolidated financial statements, in 2006, the Company adopted Statement of Financial Accounting Standard Board No. 123 (revised 2004) "Share-Based Payments".

Tel-Aviv, Israel
January 28, 2007

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | December 31, | |
|---|--------------|------------|
| | 2005 | 2006 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 56,263 | \$ 25,324 |
| Bank deposit | 10,195 | - |
| Available-for-sale marketable securities | 14,717 | 92,133 |
| Held-to-maturity marketable securities | 45,726 | 22,918 |
| Trade receivables (net of allowance for doubtful accounts of \$ 1,006 and \$ 1,106 in 2005 and 2006, respectively) *) | 14,661 | 17,453 |
| Other receivables and prepaid expenses | 1,451 | 1,996 |
| Inventories | 5,254 | 6,892 |
| Total current assets | 148,267 | 166,716 |
| LONG-TERM INVESTMENTS: | | |
| Structured note | 9,458 | 9,602 |
| Available-for-sale marketable securities | 11,399 | 14,154 |
| Held-to-maturity marketable securities | 16,735 | - |
| Severance pay fund | 2,178 | 2,907 |
| Total long-term investments | 39,770 | 26,663 |
| PROPERTY AND EQUIPMENT, NET | 5,968 | 9,253 |
| LONG-TERM DEFERRED TAXES AND OTHER LONG-TERM ASSETS | 1,075 | 1,219 |
| INTANGIBLE ASSETS, NET | 2,813 | 2,363 |
| GOODWILL | 6,454 | 9,454 |
| Total assets | \$ 204,347 | \$ 215,668 |

*) Includes balances in the amount of \$ 1,447 and \$ 1,452 with related parties as of December 31, 2005 and 2006, respectively (see also Note 13a).

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share and per share data

| | December 31, | |
|---|--------------|------------|
| | 2005 | 2006 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables *) | \$ 5,329 | \$ 6,956 |
| Deferred revenues | 12,424 | 15,712 |
| Other payables and accrued expenses | 6,509 | 6,642 |
| | | |
| Total current liabilities | 24,262 | 29,310 |
| | | |
| ACCRUED SEVERANCE PAY | 2,659 | 3,944 |
| | | |
| COMMITMENTS AND CONTINGENT LIABILITIES | | |
| | | |
| SHAREHOLDERS' EQUITY: | | |
| Share capital: | | |
| Ordinary shares of NIS 0.1 par value: | | |
| Authorized - 30,000,000 as of December 31, 2005 and 2006; Issued - 19,061,760 shares and 20,258,758 shares as of December 31, 2005 and 2006, respectively; outstanding 19,061,760 shares and 19,411,903 shares as of December 31, 2005 and 2006, respectively | 470 | 478 |
| Additional paid-in capital | 153,010 | 170,090 |
| Deferred stock based compensation | (67) | - |
| Treasury stock, at cost | - | (11,049) |
| Accumulated other comprehensive loss | (404) | (242) |
| Retained earnings | 24,417 | 23,137 |
| | | |
| Total shareholders' equity | 177,426 | 182,414 |
| | | |
| Total liabilities and shareholders' equity | \$ 204,347 | \$ 215,668 |

*) See Note 13a for balances with related parties.

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands, except share per share data

| | Year ended December 31, | | |
|--|-------------------------|-----------|------------|
| | 2004 | 2005 | 2006 |
| Revenues: *) | | | |
| Products | \$ 52,206 | \$ 55,902 | \$ 57,335 |
| Services | 16,233 | 21,682 | 24,075 |
| Total revenues | 68,439 | 77,584 | 81,410 |
| Cost of revenues: *) | | | |
| Products | 8,080 | 9,325 | 10,267 |
| Services | 4,104 | 5,571 | 5,524 |
| Total cost of revenues | 12,184 | 14,896 | 15,791 |
| Gross profit | 56,255 | 62,688 | 65,619 |
| Operating expenses: *) | | | |
| Research and development, net | 10,342 | 13,017 | 17,659 |
| Sales and marketing | 31,898 | 40,002 | 50,128 |
| General and administrative | 4,493 | 5,244 | 6,178 |
| Total operating expenses | 46,733 | 58,263 | 73,965 |
| Operating income (loss) | 9,522 | 4,425 | (8,346) |
| Financial income, net | 4,565 | 5,159 | 7,422 |
| Income (loss) before income taxes | 14,087 | 9,584 | (924) |
| Income taxes | (341) | (240) | (356) |
| Net income (loss) before minority interest in losses of a subsidiary | 13,746 | 9,344 | (1,280) |
| Minority interest in losses of a subsidiary | 34 | - | - |
| Net income (loss) | \$ 13,780 | \$ 9,344 | \$ (1,280) |
| Basic net earnings (loss) per share | \$ 0.77 | \$ 0.50 | \$ (0.07) |
| Diluted net earnings (loss) per share | \$ 0.70 | \$ 0.47 | \$ (0.07) |

*) See Note 13b for transactions with related parties.

The accompanying notes are an integral part of the consolidated financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

| | Number of outstanding Ordinary shares | Share capital | Additional paid-in capital | Deferred stock based compensation | Treasury shares, at cost | Accumulated other comprehensive loss | Retained earnings | Total comprehensive income (loss) | Total |
|--|--|------------------|----------------------------------|---|--------------------------------|---|----------------------|---|------------|
| Balance as of January 1, 2004 | 17,704,183 | \$ 439 | \$ 138,552 | \$ - | \$ - | (38) | \$ 1,293 | | \$ 140,246 |
| Issuance of shares upon exercise of stock options and upon purchase of shares under ESPP | 784,347 | 18 | 6,887 | - | - | - | - | | 6,905 |
| Comprehensive income: | | | | | | | | | |
| Unrealized losses from available-for-sale securities, net | - | - | - | - | - | (14) | - | \$ (14) | (14) |
| Net income | - | - | - | - | - | - | 13,780 | 13,780 | 13,780 |
| Total comprehensive income | | | | | | | | \$ 13,766 | |
| Balance as of December 31, 2004 | 18,488,530 | 457 | 145,439 | - | - | (52) | 15,073 | | 160,917 |
| Issuance of shares upon exercise of stock options and upon purchase of shares under ESPP | 573,230 | 13 | 7,298 | - | - | - | - | | 7,311 |
| Deferred stock based compensation | - | - | 125 | (125) | - | - | - | | - |
| Amortization of deferred stock based compensation | - | - | - | 58 | - | - | - | | 58 |
| Warrants issued in respect of business combination | - | - | 148 | - | - | - | - | | 148 |
| Comprehensive income: | | | | | | | | | |
| Unrealized losses from available-for-sale securities, net | - | - | - | - | - | (352) | - | \$ (352) | (352) |
| Net income | - | - | - | - | - | - | 9,344 | 9,344 | 9,344 |
| Total comprehensive income | | | | | | | | \$ 8,992 | |
| Balance as of December 31, 2005 | 19,061,760 | 470 | 153,010 | (67) | - | (404) | 24,417 | | 177,426 |
| Repurchase of shares | (846,855) | (20) | - | - | (11,049) | - | - | | (11,069) |
| Issuance of shares upon exercise of stock options | 1,196,998 | 28 | 12,607 | - | - | - | - | | 12,635 |
| Stock based compensation | - | - | 4,540 | - | - | - | - | | 4,540 |
| Reclassification of deferred stock compensation into additional paid-in capital upon adoption of SFAS 123(R) | - | - | (67) | 67 | - | - | - | | - |
| Comprehensive income: | | | | | | | | | |
| Unrealized income from available-for-sale securities, net | - | - | - | - | - | 162 | - | \$ 162 | 162 |
| Net loss | - | - | - | - | - | - | (1,280) | (1,280) | (1,280) |
| Total comprehensive income (loss) | | | | | | | | \$ (1,118) | |
| Balance as of December 31, 2006 | 19,411,903 | \$ 478 | \$ 170,090 | \$ - | \$ (11,049) | \$ (242) | \$ 23,137 | | \$ 182,414 |

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, | | |
|--|-------------------------|-----------|------------|
| | 2004 | 2005 | 2006 |
| <u>Cash flows from operating activities:</u> | | | |
| Net income (loss) | \$ 13,780 | \$ 9,344 | \$ (1,280) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization (including amortization of deferred compensation costs relating to employees of V-Secure) | 1,429 | 1,921 | 2,976 |
| Stock based compensation | - | 58 | 4,540 |
| Minority interest in losses of a subsidiary | (34) | - | - |
| Amortization of premiums, accretion of discounts and accrued interest on available-for-sale and held-to-maturity marketable debt securities, net | 318 | (475) | 458 |
| Accrued interest on bank deposits and structured note | 791 | 1,468 | 51 |
| Accrued severance pay, net | 288 | 3 | 556 |
| Decrease (increase) in long-term deferred taxes | (350) | 20 | (241) |
| Increase in trade receivables, net | (3,476) | (1,495) | (2,792) |
| Increase in other receivables and prepaid expenses | (243) | (119) | (545) |
| Increase in inventories | (1,096) | (1,160) | (1,520) |
| Increase in trade payables | 790 | 245 | 1,627 |
| Increase in deferred revenues | 2,830 | 2,536 | 3,288 |
| Increase in other payables and accrued expenses | 123 | 1,547 | 133 |
| Other | 1 | (43) | - |
| Net cash provided by operating activities | 15,151 | 13,850 | 7,251 |
| <u>Cash flows from investing activities:</u> | | | |
| Purchase of property and equipment | (2,369) | (3,626) | (5,843) |
| Proceeds from sale of property and equipment | 16 | 297 | - |
| Investment in other long-term assets | (225) | (24) | 11 |
| Purchase of available-for-sale marketable debt securities | (21,281) | (86) | (109,336) |
| Purchase of held-to-maturity marketable debt securities | (31,320) | (31,962) | (6,000) |
| Proceeds from sale and redemption of available-for-sale marketable debt securities | 13,369 | 16,265 | 29,327 |
| Proceeds from redemption of held-to-maturity marketable debt securities | - | 1,462 | 45,085 |
| Investment in long-term bank deposits | (2,890) | - | - |
| Proceeds from maturity of long-term bank deposit | - | 62,995 | - |
| Investment in bank deposit | - | (10,000) | - |
| Proceeds from bank deposits | - | - | 10,000 |
| Increase in holdings in a subsidiary | (335) | - | - |
| Payment for the acquisition of V-Secure (1) | - | (9,011) | (3,000) |
| Net cash provided by (used in) investing activities | (45,035) | 26,310 | (39,756) |
| <u>Cash flows from financing activities:</u> | | | |
| Proceeds from exercise of stock options | 6,905 | 7,311 | 12,635 |
| Repurchase of shares | - | - | (11,069) |
| Net cash provided by financing activities | 6,905 | 7,311 | 1,566 |
| Increase (decrease) in cash and cash equivalents | (22,979) | 47,471 | (30,939) |
| Cash and cash equivalents at the beginning of the year | 31,771 | 8,792 | 56,263 |
| Cash and cash equivalents at the end of the year | \$ 8,792 | \$ 56,263 | \$ 25,324 |
| (1) <u>Payment for the acquisition of V-Secure:</u> | | | |
| Estimated fair value of assets acquired at the date of acquisition: | | | |
| Acquired technology | \$ - | \$ 1,772 | \$ - |
| Customers relationships | - | 542 | - |
| Deferred compensation cost | - | 400 | - |
| Goodwill | - | 6,297 | 3,000 |
| | \$ - | \$ 9,011 | \$ 3,000 |
| <u>Supplemental disclosure of cash flow activities:</u> | | | |
| Cash paid during the year for: | | | |
| Taxes | \$ 1,494 | \$ - | \$ - |

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL

- a. Radware Ltd. ("the Company"), an Israeli corporation, and its subsidiaries ("the Group"), commenced operations in April 1997. The Company is engaged in the development, manufacture and sale of Application Delivery and Network Security ("business smart networking") solutions that provide end-to-end availability, performance and security of mission critical networked applications. The Company's products are marketed worldwide.
- b. The Company established wholly-owned subsidiaries in the United States, France, Germany, Singapore, the United Kingdom, Japan, Korea, Canada, Switzerland and Italy. In addition, the Company established branches and representative offices in China, India, Russia and Taiwan. In Australia, the Company held approximately 83% of its Australian subsidiary as of January 1, 2004; the additional 17% was purchased by the Company during 2004 for a total amount of \$ 335. The Company's subsidiaries are engaged primarily in sales, marketing and support activities.
- c. The Company depends on a single supplier to supply certain components for the production of its products. If this supplier fails to deliver or delays the delivery of the necessary components, the Company will be required to seek alternative sources of supply. A change in suppliers could result in manufacturing delays, which could cause a possible loss of sales and, consequently, could adversely affect the Company's results of operations and financial position.
- d. The Company relies upon independent distributors (which are considered to be end-users) to market and sell its products to customers. A loss of a major distributor, or any event negatively affecting such distributor's financial condition, could cause a material adverse effect on the Company's results of operations and financial position.
As of December 31, 2004, 2005 and 2006 one single customer (a distributor) represented 11%, 16% and 12%, respectively, of the Company's total revenues.
- e. Business combination - acquisition of V-Secure Technologies (US) Inc. ("V-Secure"):

In December 2005, the Company acquired the business of V-Secure which included the acquisition of its technology, customer relationships and goodwill. The total consideration for the acquisition was \$ 9,168, out of which an amount of \$ 9,011 was paid in cash; amount valued as \$ 148 was paid by issuance of fully vested warrants to V-Secure to purchase 45,454 Ordinary shares of the Company, at an exercise price of \$ 22 per share. The remaining balance was related to acquisition costs.

According to the agreement between the parties, additional cash consideration of \$ 6,000 (earn-out) was payable contingent upon meeting a certain technological milestone in regards to the integrated product of the Company and V-Secure. During 2006, a partial amount of \$ 3,000 out of total consideration of \$ 6,000 was paid according to an amended agreement between the Company and V-Secure's shareholders. According to the agreement V-Secure's shareholders waived any claim or demand for additional payment.

The amount paid resulted in recording additional goodwill.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

The purchase price was allocated to the identifiable intangible assets acquired (which have been valued by management using a third party valuation specialist) based upon their estimated fair values as follows:

| | | |
|--|----|----------------------|
| Acquired technology | \$ | 1,772 |
| Customers relationships | | 542 |
| Goodwill (including additional \$ 3,000 paid and recorded during 2006) | | <u>9,454</u> |
| | | |
| Total intangible assets | | 11,768 |
| Deferred compensation cost | | <u>400</u> |
| | | |
| Total consideration | \$ | <u><u>12,168</u></u> |

The deferred compensation cost was carved-out of the goodwill and represents incentive to former employees of V-Secure that will remain with the Company for periods of no less than 12 to 24 months. Such deferred compensation cost is amortized over the employment period, and is recorded as compensation costs. Any amount not used for bonuses is returned to V-Secure, and will increase the goodwill. During 2006, an amount of \$84 was recorded as compensation costs, included in research and development expenses.

The acquisition of V-Secure was accounted for under the purchase method of accounting.

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), goodwill arising from the acquisition will not be amortized. In lieu of amortization, the Company is required to perform an annual impairment review. If the Company determines, through the impairment review process, that goodwill has been impaired, it will record the impairment charge in its statement of income. During the year ended December 31, 2006, no such impairment loss was recorded.

Unaudited pro-forma results:

The following represents the unaudited pro-forma results of operations of V-Secure and the Company's consolidated statements of income for the years ended December 31, 2004 and 2005, assuming that V-Secure's acquisition occurred on January 1, of each year:

| | Year ended December 31, | |
|-------------------------------|-------------------------|------------------|
| | 2004 | 2005 |
| | Unaudited | |
| | Total consolidated | |
| Revenues | \$ <u>69,069</u> | \$ <u>78,145</u> |
| Net income | \$ <u>9,747</u> | \$ <u>5,033</u> |
| Diluted net earning per share | \$ <u>0.49</u> | \$ <u>0.25</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company and its subsidiaries are generated in U.S. dollars ("dollar" or "dollars"). In addition, a substantial portion of the Company's and certain of its subsidiaries' costs is incurred in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of the Financial Accounting Standard Board No. 52 "Foreign Currency Translation" ("SFAS No. 52"). All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions including profits from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less.

e. Marketable securities:

The Company accounts for investments in marketable debt securities in accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity and are stated at amortized cost. The amortized cost of held-to-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and decline in value judged to be other than temporary and interest are included in financial income, net. As of December 31, 2006, no impairment has been identified.

Debt securities that are designated as available-for-sale are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in financial income, net. The Company has the positive ability to hold the securities to maturity. As of December 31, 2006, no impairment has been identified.

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories and discontinued products. As of December 31, 2005 and 2006, the provision for inventory write-offs amounted to \$ 846 and \$ 783, respectively. Any write-off is recognized in the consolidated statements of operations as cost of revenues.

Cost is determined as follows:

- Raw materials and components - using the "first-in, first-out" method.
- Work-in-progress and finished products:
 - Raw materials and components - using the "first-in, first-out" method.
 - Subcontracting costs - on the basis of direct subcontractors costs with the addition of allocable costs.

g. Structured note:

Structured note as of December 31, 2006, consists of a callable structured note ("Structured Note") with a maturity of seven years. The Structured Note bears interest that varies inversely with changes of the three-month USD LIBOR-rate.

As of December 31, 2006, the Structured Note amounted to \$ 9,602. Interest income resulting from investment in the Structured Note is accounted for based on the guidelines provided in the Emerging Issues Task Force ("EITF") No. 96-12, "Recognition of Interest Income and Balance Sheet Classification of Structured Notes". Under EITF No. 96-12, the retrospective interest method is used for recognizing interest income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Property and equipment, net:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets at the following annual rates:

| | <u>%</u> |
|---|--|
| Computer, software and peripheral equipment | 15-33 |
| Office furniture and equipment | 7-15 |
| Motor vehicles | 15 |
| Leasehold improvements | Over the shorter of the term of the lease or the life of the asset |

i. Impairment of long-lived assets:

The Company's and its subsidiaries' long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset, may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2006, no impairment losses have been identified.

j. Goodwill:

Goodwill represents excess of the costs over the fair value of net assets of businesses acquired. Under SFAS No. 142, goodwill is not amortized. SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value with its carrying value. Fair value is determined using discounted cash flows and market multiples. During the year ended December 31, 2006 no such impairment losses were recorded.

k. Intangible assets:

Intangible assets are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. Acquired technology and customer relationships are amortized using the straight-line method over an estimated period between six to ten years during which benefits are expected to be received. During 2006, an amount of \$ 450 was recorded as amortization expenses, included in cost of revenues and sales and marketing expenses. As of December 31, 2006, no impairment losses have been identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Revenue recognition:

The Company and its subsidiaries generate revenues mainly from selling their products and from post-contract customer support primarily through distributors and resellers, all of which are considered end-users.

Revenues from product sales are recognized when delivery has occurred, persuasive evidence of an agreement exists, the fee is fixed or determinable, no further obligation exists and collectability is probable.

Revenues in arrangements with multiple deliverables are recognized under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements, no VSOE exists for the delivered elements, and all other revenue recognition criteria are satisfied. VSOE for post-contract customer support is determined based on the price when it is sold separately in similar arrangements. The price may vary in the territories and vertical markets in which the Company conducts business. Price is determined by using a consistent percentage of the Company's product price lists.

Service revenue derived from post-contract customer support, which represents mainly help desk support, unit replacement and security update service, is recognized ratably over the contract period, which is typically one year.

Service revenues from training and installation, which are considered as not essential to the functionality of the product, included in multiple elements arrangements are recognized at the time they are rendered.

The Company and its subsidiaries provide a provision for product returns and stock rotation based on their experience with historical sales returns, analysis of credit memo data and other known factors, in accordance with Statement of Financial Accounting Standard No. 48, "Revenue Recognition When Right of Return Exists" ("SFAS No. 48").

Deferred revenue includes unearned amounts received under post-contract customer support.

m. Warranty costs:

The Company generally offers a one year warranty for all of its products. A provision for warranty costs is provided at the time revenues are recognized and for estimated material costs during the warranty period based on the Company's experience. Warranty expenses for the years ended December 31, 2004, 2005 and 2006 were immaterial.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)") which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB No. 107") relating to SFAS No. 123(R). The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

SFAS No. 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated income statement. Prior to the adoption of SFAS 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123").

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard starting from January 1, 2006, the first day of the Company's fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

The Company has two stock option plans, the Company's Key Employee Share Incentive Plan (1997) and the Directors and Consultants Option Plan ("the Stock Option Plans"). Under the Stock Option Plans, options may be granted to officers, directors, employees and consultants of the Company or its subsidiaries. The options expire six years from the grant date. The options vest primarily over four years. Each option is exercisable for one Ordinary share. Any options, which are forfeited or not exercised before expiration, become available for future grants.

Pursuant to the Stock Option Plans, the Company reserved for issuance 8,087,071 Ordinary shares. The Company approved in July 2006, an increase of 3% of issued and outstanding Ordinary shares reserved for option grants under the Stock Option Plans. As of December 31, 2006, an aggregate of 695,269 Ordinary shares of the Company were still available for future grants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company recognizes compensation expenses for the value of its awards, based on the accelerated attribution method, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's income before income taxes and net income for the year ended December 31, 2006, is approximately \$ 4,500 lower than if it had continued to account for stock-based compensation under APB No. 25. Basic and diluted net earnings per share for the year ended December 31, 2006, are \$ 0.24 and \$ 0.23 respectively, lower than if the Company had continued to account for share-based compensation under APB No. 25.

Prior to January 1, 2006, the Company applied the intrinsic value method of accounting for stock options as prescribed by APB No. 25, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price at the grant date of the award. During the years ended December 31, 2004 and 2005, the Company recognized stock-based compensation expense related to employee stock options under the plans in the amounts of \$ 0 and \$ 58, respectively.

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements.

The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the simplified method permitted by SAB No. 107 as the average of the vesting period and the contractual term. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value of the Company's stock options granted to employees and directors for the years ended December 31, 2004, 2005 and 2006 was estimated using the following weighted average assumptions:

| | Year ended December 31, | | |
|--------------------------|----------------------------|------|------|
| | 2004 | 2005 | 2006 |
| Risk free interest | 2.5% | 4.5% | 4.9% |
| Dividend yields | 0% | 0% | 0% |
| Volatility | 75% | 41% | 50% |
| Expected term (in years) | 2.5 | 3.5 | 3.9 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data
NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

A summary of employee option activity under the Company's Stock Option Plans as of December 31, 2006 and changes during the year ended December 31, 2006 are as follows:

| | <u>Number of options</u> | <u>Weighted- average exercise price</u> | <u>Weighted- average remaining contractual term (in years)</u> | <u>Aggregate intrinsic value</u> |
|--|------------------------------|---|--|--------------------------------------|
| Outstanding at January 1, 2006 | 4,054,380 | \$ 14.31 | | |
| Granted | 1,122,400 | \$ 14.69 | | |
| Exercised | (1,196,998) | \$ 10.55 | | |
| Forfeited and cancelled | <u>(694,783)</u> | <u>\$ 17.48</u> | | |
| Outstanding at December 31, 2006 | <u>3,284,999</u> | <u>\$ 15.13</u> | <u>3.13</u> | <u>\$ 5,749</u> |
| Exercisable at December 31, 2006 | <u>1,034,230</u> | <u>\$ 13.18</u> | <u>1.61</u> | <u>\$ 3,779</u> |
| Vested and expected to vest at December 31, 2006 | <u>2,799,618</u> | <u>\$ 15.69</u> | <u>3.04</u> | <u>\$ 4,445</u> |

A summary of the employee option activity under the Company’s Stock Option Plans as of December 31, 2005 and 2004, and changes in activity during the years ended on those dates, are as follow:

| | <u>December 31, 2004</u> | | <u>December 31, 2005</u> | |
|--|------------------------------|--|------------------------------|--|
| | <u>Number of options</u> | <u>Weighted average exercise price</u> | <u>Number of options</u> | <u>Weighted average exercise price</u> |
| Options outstanding at the beginning of the year | 3,951,840 | \$ 11.12 | 3,902,433 | \$ 13.21 |
| Changes during the year: | | | | |
| Granted | 1,112,933 | \$ 19.10 | 1,007,250 | \$ 18.80 |
| Exercised | (669,865) | \$ 8.93 | (503,591) | \$ 12.15 |
| Expired | (1,625) | \$ 10.69 | (45,174) | \$ 45.88 |
| Forfeited and cancelled | <u>(490,850)</u> | <u>\$ 15.64</u> | <u>(306,538)</u> | <u>\$ 13.96</u> |
| Options outstanding at the end of the year | <u>3,902,433</u> | <u>\$ 13.21</u> | <u>4,054,380</u> | <u>\$ 14.31</u> |
| Options exercisable at the end of the year | <u>1,251,679</u> | <u>\$ 10.24</u> | <u>1,428,575</u> | <u>\$ 9.52</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The weighted-average grant-date fair value of options granted during the years ended December 31, 2004, 2005 and 2006 was \$ 8.6 and \$ 7.1 and \$ 5.04, respectively. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006. This amount changes, based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the year ended December 31, 2006 was approximately \$ 6,394. As of December 31, 2006, there was approximately \$ 6,451 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 1.03 years. Total grant-date fair value of vested options for the year ended December 31, 2006 was approximately \$ 5,668.

The options outstanding under the Company's Stock Option Plans as of December 31, 2006, have been separated into ranges of exercise price as follows:

| Ranges of exercise price | Options outstanding as of December 31, 2006 | Weighted average remaining contractual life (years) | Weighted average exercise price | Options Exercisable as of December 31, 2006 | Weighted average exercise price of exercisable options |
|--------------------------|---|---|---------------------------------|---|--|
| \$ 8-11 | 542,483 | 1.18 | \$ 8.97 | 493,205 | \$ 8.77 |
| \$ 12.5-15 | 1,291,350 | 3.67 | \$ 14.34 | 300,000 | \$ 15.00 |
| \$ 16-17 | 631,350 | 2.57 | \$ 16.94 | 72,900 | \$ 16.99 |
| \$ 18-20.08 | 540,233 | 3.46 | \$ 18.78 | 96,459 | \$ 19.48 |
| \$ 23.13-25.30 | 279,583 | 2.99 | \$ 23.88 | 71,666 | \$ 23.49 |
| | 3,284,999 | | | 1,034,230 | |

The following table illustrates the effect on the net income and net earnings per share, assuming that the Company had applied the fair value recognition provision of SFAS No. 123 on its stock-based employee compensation:

| | Year ended December 31, | |
|--|-------------------------|----------|
| | 2004 | 2005 |
| Net income as reported | \$ 13,780 | \$ 9,344 |
| Add: stock-based employee compensation expenses included in reported net loss - intrinsic value | - | 58 |
| Deduct: total stock-based employee compensation expense determined under fair value based method | (7,520) | (6,082) |
| Pro forma net income | \$ 6,260 | \$ 3,320 |
| Basic net income per share as reported | \$ 0.77 | \$ 0.50 |
| Diluted net income per share as reported | \$ 0.70 | \$ 0.47 |
| Pro forma basic net earnings per share | \$ 0.35 | \$ 0.18 |
| Pro forma diluted net earnings per share | \$ 0.32 | \$ 0.17 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- o. Research and development expenses:

Research and development expenses, net of grants received are charged to the statement of operations, as incurred. Development grants deducted from research and development expenses amounted to \$ 0, \$ 200 and \$ 200 for the years ended December 31, 2004, 2005 and 2006 respectively.

- p. Advertising expenses:

Advertising expenses are charged to the statements of operations as incurred.

- q. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Standard No. 128, "Earnings per Share" ("SFAS No. 128").

The weighted average number of shares related to outstanding anti dilutive options excluded from the calculation of diluted earnings (loss) per share was 709,972 and 1,763,760 for the years ended December 31, 2005 and 2006, respectively.

- r. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that a portion or all of the deferred tax assets will not be realized.

- s. Concentrations of credit risks:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, bank deposits, marketable securities, trade receivables and structured note.

The majority of the Company's and its subsidiaries' cash and cash equivalents, and bank deposits are invested in major banks in the United States and in the United Kingdom in U.S. dollars. Management believes that the financial institutions that hold the Company's investments are financially sound and accordingly, minimal credit risk exists with respect to these investments. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's marketable securities include investments in U.S. government debentures; foreign banks and government debentures and corporate debentures. Management believes that those corporations and governments are financially sound and that the portfolios are well-diversified, and accordingly, minimal credit risk exists with respect to these marketable securities. Moreover, the Company's investment policy, limits the amount the Company may invest in any one type of investment, thereby reducing credit risk concentration.

The trade receivables of the Company and its subsidiaries are mainly derived from sales to customers located primarily in the United States, Europe, the Middle East, Africa and Asia Pacific. The Company performs ongoing credit evaluations of its customers. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. In certain circumstances, the Company may require from its customers letters of credit, other collateral or additional guarantees.

As of December 31, 2005 and 2006, the Company and its subsidiaries had no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

t. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of its Israeli employees is fully provided by monthly deposits with insurance policies and by an accrual.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to the Israeli Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expenses for the years ended December 31, 2004, 2005, and 2006, amounted to approximately \$ 774, \$ 405 and \$ 1,015, respectively.

u. Fair value of financial instruments:

The following methods and assumptions were used by the Company and its subsidiaries in estimating fair value and disclosures for financial instruments:

The carrying amount reported in the balance sheet of cash and cash equivalents, bank deposits, trade receivables, other receivables and prepaid expenses, trade payables and other payables and accrued expenses approximates their fair values due to the short-term maturities of such instruments.

The fair values for marketable securities are based on quoted market prices and do not significantly differ from carrying amounts (see also Note 3).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The carrying amount of the Company's structured note is estimated by discounting the future cash flows using the future prospected interest rates for deposits of similar terms and maturities. The carrying amount of the structured note does not significantly differ from its fair value.

v. Impact of recently issued Accounting Standards:

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from Financial Accounting Standards Board Statement No. 5, "Accounting for Contingencies." FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). FIN 48 applies to all tax positions related to income taxes subject to Financial Accounting Standards Board Statement No. 109, "Accounting for Income Taxes." This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management is in a process of evaluating the possible impact of the adoption of FIN 48 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Management believes that SFAS No. 157 will not have a material effect on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 no later than January 1, 2008. The Company has not yet determined the effect that the adoption of SFAS No. 159 will have on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 3:- MARKETABLE SECURITIES

The Company invests in marketable debt securities, which are classified as available-for-sale and held-to-maturity investments. The following is a summary of marketable debt securities:

| | December 31, | | | | | |
|--|----------------|-------------------|--------------|----------------|-------------------|--------------|
| | 2005 | | | 2006 | | |
| | Amortized cost | Unrealized losses | Market value | Amortized cost | Unrealized losses | Market value |
| Available-for-sale: | | | | | | |
| U.S. Government debentures | \$ 6,035 | \$ (114) | \$ 5,921 | \$ 97,151 | \$ (177) | \$ 96,974 |
| Foreign banks and government debentures | 8,376 | (196) | 8,180 | 2,774 | (35) | 2,739 |
| Corporate debentures | 3,859 | (94) | 3,765 | 6,604 | (30) | 6,574 |
| Auction rate securities | 8,250 | - | 8,250 | - | - | - |
| Total available-for-sale marketable securities | \$ 26,520 | \$ (404) | \$ 26,116 | \$ 106,529 | \$ (242) | \$ 106,287 |
| Held-to-maturity: | | | | | | |
| U.S. Government debentures | \$ 62,461 | \$ (1,304) | \$ 61,157 | \$ 22,918 | \$ (183) | \$ 22,735 |

The unrealized losses on available-for-sale debt securities included in other comprehensive income, as a separate component of shareholders' equity, totaled to \$ 404 and \$ 242 as of December 31, 2005 and 2006, respectively.

The unrealized losses on the Company's investments in held-to-maturity securities and in available-for-sale securities are a result of interest rate changes. Since the Company has the ability and intent to hold these investments until a recovery of fair value, which may be until maturity, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2006.

The amortized cost and estimated fair value of available-for-sale and held-to-maturity investments as of December 31, 2005 and 2006, by contractual maturity, are as follows:

| | December 31, | | | |
|--------------------------------|----------------|--------------|----------------|--------------|
| | 2005 | | 2006 | |
| | Amortized cost | Market value | Amortized cost | Market value |
| Available-for-sale: | | | | |
| Matures in one year | \$ 14,832 | \$ 14,717 | \$ 92,291 | \$ 92,133 |
| Matures in one to three years | 8,966 | 8,692 | 14,238 | 14,154 |
| | 23,798 | 23,409 | 106,529 | 106,287 |
| Matures in three to five years | 2,722 | 2,707 | - | - |
| | \$ 26,520 | \$ 26,116 | \$ 106,529 | \$ 106,287 |
| Held-to-maturity: | | | | |
| Matures in one year | \$ 45,726 | \$ 44,784 | \$ 22,918 | \$ 22,735 |
| Matures in one to three years | 16,735 | 16,373 | - | - |
| | \$ 62,461 | \$ 61,157 | \$ 22,918 | \$ 22,735 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 4:- INVENTORIES

Inventories are comprised of the following:

| | December 31, | |
|------------------------------|-----------------|-----------------|
| | 2005 | 2006 |
| Raw materials and components | \$ 515 | \$ 562 |
| Work-in-progress | 2,457 | 2,702 |
| Finished products | 2,282 | 3,628 |
| | <u>\$ 5,254</u> | <u>\$ 6,892</u> |

NOTE 5:- PROPERTY AND EQUIPMENT, NET

| | December 31, | |
|---|-----------------|-----------------|
| | 2005 | 2006 |
| Cost: | | |
| Computer, software and peripheral equipment | \$ 12,001 | \$ 17,249 |
| Office furniture and equipment | 1,152 | 1,358 |
| Motor vehicles | 166 | 97 |
| Leasehold improvements | 689 | 771 |
| | <u>14,008</u> | <u>19,475</u> |
| Accumulated depreciation: | | |
| Computer, software and peripheral equipment | 7,020 | 9,046 |
| Office furniture and equipment | 514 | 644 |
| Motor vehicles | 144 | 81 |
| Leasehold improvements | 362 | 451 |
| | <u>8,040</u> | <u>10,222</u> |
| Depreciated cost | <u>\$ 5,968</u> | <u>\$ 9,253</u> |

Depreciation expenses for the years ended December 31, 2004, 2005 and 2006 were \$ 1,381, \$ 1,856 and \$ 2,440, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 6:- INTANGIBLE ASSETS

a. Intangible assets:

| | Weighted average amortization Years | December 31, | |
|---------------------------|--|--------------|----------|
| | | 2005 | 2006 |
| | | | |
| Cost: | | | |
| Acquired technology | 6 | \$ 1,772 | \$ 1,772 |
| Customers relationships | 6-10 | 1,189 | 1,189 |
| | | 2,961 | 2,961 |
| Accumulated amortization: | | | |
| Acquired technology | | - | 296 |
| Customers relationships | | 148 | 302 |
| | | 148 | 598 |
| Amortized cost | | \$ 2,813 | \$ 2,363 |

Amortization expenses for the years ended December 31, 2004, 2005 and 2006, were \$ 49, \$ 65 and \$ 450, respectively.

b. Estimated amortization expenses for the years ended:

| December 31, | |
|----------------|----------|
| 2007 | \$ 450 |
| 2008 | 450 |
| 2009 | 450 |
| 2010 | 450 |
| 2011 | 450 |
| 2012 and after | 113 |
| | |
| Total | \$ 2,363 |

NOTE 7:- OTHER PAYABLES AND ACCRUED EXPENSES

| | December 31, | |
|--------------------------------|--------------|----------|
| | 2005 | 2006 |
| Employees and payroll accruals | \$ 3,257 | \$ 4,057 |
| Accrued expenses | 2,941 | 2,305 |
| Provision for warranty costs | 190 | 200 |
| Other | 121 | 80 |
| | | |
| | \$ 6,509 | \$ 6,642 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Operating leases:

The Company and its subsidiaries rent their facilities under various operating lease agreements, which expire on various dates, the latest of which is in 2010. Aggregate minimum rental payments under non-cancelable operating leases as of December 31, 2006, are as follows:

| | | |
|------|----|--------------|
| 2007 | \$ | 1,606 |
| 2008 | | 695 |
| 2009 | | 374 |
| 2010 | | 60 |
| | | <u>60</u> |
| | \$ | <u>2,735</u> |

Total rent expenses for the years ended December 31, 2004, 2005 and 2006, were approximately \$ 1,554, \$ 1,768 \$ 1,948, respectively (see also Note 13b).

b. Litigation:

- (1) In December 2001, the Company, its Chairman, its President and Chief Executive Officer and its Chief Financial Officer (the “Individual Defendants”) and several underwriters in the syndicates for the Company’s September 30, 1999 Initial Public Offering (“IPO”) and January 24, 2000 secondary offering, were named as defendants in a class action complaint alleging violations of the federal securities laws in the United States District Court, Southern District of New York.

The complaint seeks unspecified damages as a result of alleged violations of Section 11 of the Securities Act of 1933 against all the defendants and Section 15 of the Securities Act of 1933 against the Individual Defendants arising from activities purportedly engaged in by the underwriters in connection with the Company’s IPO and secondary offering. Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company’s IPO and secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices.

An amended complaint filed on April 19, 2002, which is now the operative complaint, added a claim under Section 10(b) of the Securities Exchange Act of 1934 against the Company and a claim under Section 20(a) of the Securities Exchange Act of 1934 against the Individual Defendants. Plaintiffs allege that the Prospectuses for the Company’s IPO and secondary offering were false and misleading because they did not disclose these arrangements. The action is being coordinated with approximately three hundred other nearly identical actions filed against other companies before one judge in the U.S. District Court for the Southern District of New York.

A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Individual Defendants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

This dismissal disposed of the Section 15 and 20(a) control person claims without prejudice, since these claims were asserted only against the Individual Defendants.

On February 19, 2003, the Court denied the motion to dismiss with respect to the Company.

On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The underwriter defendants appealed the decision and the Second Circuit vacated the district court's decision granting class certification in those six cases on December 5, 2006. Plaintiffs filed a petition for rehearing (see also Note 14b).

Prior to the Second Circuit's December 5, 2006 ruling, the Company approved a settlement agreement and related agreements which set forth the terms of a settlement between the Company, the Individual Defendants, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. These agreements were submitted to the Court for approval. The settlement would have provided, among other things, a release of the Company and the Individual Defendants for the conduct alleged to be wrongful in the complaint in exchange for a guarantee from the company's insurers regarding recovery from the underwriter defendants and other consideration from the Company regarding its underwriters. In light of the Second Circuit opinion, liaison counsel for the issuers informed the district court that the settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. The Company's management cannot predict whether the Company will be able to negotiate a settlement that complies with the Second Circuit's mandate.

Due to the inherent uncertainties of litigation, the Company's management cannot accurately predict the ultimate outcome of the matter. If the Company is found liable, it is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than the Company's insurance coverage, and whether such damages would have a material impact on its results of operations, cash flows or financial condition in any future period.

- (2) The Company's French subsidiary, Radware France, is a party to two separate litigation proceedings before the Boulogne-Billancourt Employment Tribunal, brought against the subsidiary by two of its former employees claiming damages in connection with their dismissal. The hearings with respect to these matters are scheduled for January 10, 2008 and April 3, 2008, respectively. At this stage without receiving all file submissions from the Tribunal. The Company's management cannot assess the outcome or the risks associated with these two matters but in any event the Company's management does not expect them to have a material affect on the Company.
- (3) From time to time, the Company is involved in routine trade litigation. The Company is not subject to any additional material legal proceedings other than those described above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data**NOTE 9:- SHAREHOLDERS' EQUITY**

The Company's shares are listed for trade on the NASDAQ National Market and since April 2004 on the Tel-Aviv Stock Exchange, both under the symbol "RDWR".

a. Treasury stock:

In July 2006, the Company's Board of Directors authorized the repurchase of up to \$ 50,000 of treasury stock in the open market, subject to normal trading restrictions. During 2006, the Company purchased 846,855 of its ordinary shares for total consideration of \$ 11,069, which was recorded as treasury stock, at cost in shareholders' equity.

b. Stock Option Plans:

See detailed information in Note 2n.

c. Dividends:

Dividends, if any, will be paid in NIS. Dividends paid to shareholders outside Israel may be converted to U.S. dollars on the basis of the exchange rate prevailing at the date of the conversion. The Company does not intend to pay cash dividends in the foreseeable future.

NOTE 10:- TAXES ON INCOME

a. Israeli income taxes:

1. Measurement of taxable income:

Commencing in taxable year 2003, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986.

2. Tax rates:

On July 25, 2005, the Knesset (Israeli Parliament) approved the Law of the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 10:- TAXES ON INCOME (Cont.)

3. Tax benefits under the Law for the Encouragement of Capital Investments, 1959:

The Company's production facilities in Israel (Tel-Aviv and Jerusalem) have been granted an "Approved Enterprise" status under the above state law. According to the provisions of such Israeli law, the Company has been granted the "Alternative Benefit Plan", under which the main benefits are tax exemption and reduced tax rate. Therefore, the Company's income derived from Approved Enterprise and allocated to the Tel Aviv facility will be entitled to a tax exemption for a period of two years and to an additional period of five to eight years with reduced tax rates of 10%-25% (based on percentage of foreign ownership). Income allocated to the Jerusalem facility will be exempt from tax for a period of up to 10 years, provided that the Company meets certain criteria. The duration of tax benefits is subject to a limitation of the earlier of 12 years from commencement of production, or 14 years from the approval date. The Company began to utilize such tax benefits in 2004 and these tax benefits we scheduled to gradually expire through 2013.

As mentioned above, the approval, which the Investment Center granted the Company, is for establishing an Approved Enterprise program in Tel-Aviv and Jerusalem, Israel. The income derived from the "Approved Enterprise" program shall be allocated between the facilities in Tel-Aviv and Jerusalem based on a mechanism as determined by the Investment Center.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the above law, regulations published hereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be partially or fully canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest.

As of December 31, 2006, retained earnings included approximately \$ 25,000 in tax-exempt income earned by the Company's "Approved Enterprise". The Company has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

If the retained tax-exempt income is distributed, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits (currently between 10% - 25%) and an income tax liability of approximately up to \$ 6,250 would be incurred by the Company.

Income from sources other than the "Approved Enterprise" will be subject to the tax at the regular rate.

During 2004, the Company's production facilities in Israel (Tel-Aviv and Jerusalem) have been granted an expansion program to its Approved Enterprise status by the Investment Center. The Company applied for an amendment to this expansion program, according to which it requested an enlargement to this expansion program, neutralization of certain assets and an approval that the benefits period from such expansion program will commence in 2006. The Investment Center has granted a temporary approval for the year 2006.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 10:- TAXES ON INCOME (Cont.)

On April 2005, an amendment to the law ("the Amendment") has changed certain provisions of the law. As a result of the Amendment, a company is no longer obliged to implement an Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authorities for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of the company's business income from export. In order to receive the tax benefits, the Amendment states that a company must make an investment in the Benefited Enterprise exceeding a minimum amount specified in the law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise ("the Year of Election"). Where a company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage of the company's production assets before the expansion. The duration of tax benefits is subject to a limitation of the earlier of 7 years from the commencement year, or 12 years from the first day of the Year of Election. As of December 31, 2006, the Company did not generate income under the provisions of the new law.

4. Tax assessments:

In 2004, the Company received final tax assessments from the Israeli Tax Authorities (the "ITA") for the tax years 1999 through 2002. The company is in a process of tax assessment with regard to the years 2003-2004.

b. Taxes on income are comprised as follows:

| | Year ended December 31, | | |
|---------------------------------|-------------------------|-----------------|-----------------|
| | 2004 | 2005 | 2006 |
| Current taxes | \$ (428) | \$ (304) | \$ (1,313) |
| Taxes in respect of prior years | (803) | - | - |
| Increase in deferred tax assets | 890 | 64 | 957 |
| | <u>\$ (341)</u> | <u>\$ (240)</u> | <u>\$ (356)</u> |
| Domestic | \$ (1,576) | \$ (203) | \$ 170 |
| Foreign | 1,235 | (37) | (526) |
| | <u>\$ (341)</u> | <u>\$ (240)</u> | <u>\$ (356)</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 10:- TAXES ON INCOME (Cont.)

c. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's and its subsidiaries' deferred tax liabilities and assets are as follows:

| | December 31, | |
|--|--------------|----------|
| | 2005 | 2006 |
| Deferred tax assets: | | |
| Carryforward tax losses | \$ 2,624 | \$ 2,378 |
| Tax benefit related to employee stock options grants | - | 900 |
| Gross deferred tax assets | 2,624 | 3,278 |
| Valuation allowance | (1,670) | (1,303) |
| Net deferred tax asset *) | 954 | 1,975 |
| Gross deferred tax liabilities | | |
| Temporary differences relating to property and equipment | - | (64) |
| Net deferred tax assets | \$ 954 | \$ 1,911 |

*) Including \$ 625 and \$ 1,405 as short-term deferred taxes as of December 31, 2005 and 2006 respectively.

During 2006 decrease in valuation allowance mainly was derived due to changes on Company’s strategy in respect of utilization of capital tax losses. As of December 31, 2006 the Company has a remaining deferred tax asset of \$1,145 relating to the available carryforward capital tax losses and changes in the tax regulatory environment.

d. Foreign:

The Company's U.S. subsidiary has estimated total available carryforward tax losses of approximately \$ 2,400 to offset against future taxable profit between 2011 and 2025. As of December 31, 2006, the Company recorded a deferred tax asset of \$ 644 relating to the available net carryforward tax losses.

Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

The Company has provided valuation allowances in respect of deferred tax assets resulting from tax benefits for which future offset is doubtful. Management currently believes that it is more likely than not that those deferred tax deductions will not be realized in the foreseeable future.

In addition, two other subsidiaries have estimated total available carryforward tax losses of approximately \$ 1,400 to offset against future taxable profit. As of December 31, 2006, the Company recorded a deferred tax asset of \$ 186 relating to these available net carryforward losses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 10:- TAXES ON INCOME (Cont.)

- e. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income (loss) of the Company and the actual tax expense as reported in the statement of operations is as follows:

| | Year ended December 31, | | |
|--|-------------------------|------------|----------|
| | 2004 | 2005 | 2006 |
| Income before taxes, as reported in the consolidated statements of income | \$ 14,087 | \$ 9,584 | \$ (924) |
| Statutory tax rate | 35% | 34% | 31% |
| Theoretical tax expenses (benefit) on the above amount at the Israeli statutory tax rate | \$ (4,930) | \$ (3,259) | \$ 286 |
| Decrease in taxes resulting from "Approved Enterprise" benefits (1) | 4,762 | 2,746 | - |
| Tax adjustment in respect of different tax rate of foreign subsidiary | (52) | 22 | (55) |
| Non-deductible expenses | (893) | (528) | (329) |
| Changes in valuation allowance in respect of deferred taxes | 1,470 | 632 | 1,267 |
| Stock compensation relating to options per SFAS 123 (R)- Non-deductible options | - | - | (500) |
| Stock compensation relating to options per SFAS 123 (R)-Deductible options for which a full valuation allowance was provided | - | - | (900) |
| Income taxes in respect of prior years | (803) | - | - |
| Other | 105 | 147 | (125) |
| Actual tax expense | \$ (341) | \$ (240) | \$ (356) |
| (1) Per share amounts (basic) of the tax benefit resulting from the exemption | \$ 0.26 | \$ 0.15 | \$ - |
| Per share amounts (diluted) of the tax benefit resulting from the exemption | \$ 0.24 | \$ 0.14 | \$ - |

- f. Income before income taxes is comprised as follows:

| | Year ended December 31, | | |
|-----------------------------------|-------------------------|----------|------------|
| | 2004 | 2005 | 2006 |
| Domestic | \$ 12,461 | \$ 7,601 | \$ (2,129) |
| Foreign | 1,626 | 1,983 | 1,205 |
| Income (loss) before income taxes | \$ 14,087 | \$ 9,584 | \$ (924) |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 11:- GEOGRAPHIC INFOROMATION AND SELECTED STATEMENTS OF INCOME DATA

Summary information about geographic areas:

The Company operates in one reportable segment (see Note 1 for a brief description of the Company's business). The total revenues are attributed to geographic areas based on the location of the end-users.

The following presents total revenues for the years ended December 31, 2004, 2005 and 2006 and long-lived assets as of December 31, 2005 and 2006:

| | Year ended December 31, | | |
|--|-------------------------|-----------|-----------|
| | 2004 | 2005 | 2006 |
| Revenues from sales to customers located at: | | | |
| America (principally the United States) | \$ 28,984 | \$ 31,900 | \$ 27,646 |
| EMEA *) | 20,450 | 24,074 | 27,529 |
| Asia Pacific | 19,005 | 21,610 | 26,235 |
| | \$ 68,439 | \$ 77,584 | \$ 81,410 |

*) Europe, the Middle East and Africa.

| | December 31, | |
|--|--------------|-----------|
| | 2005 | 2006 |
| Long-lived assets, by geographic region: | | |
| America | \$ 1,609 | \$ 1,669 |
| EMEA | 6,755 | 8,957 |
| Asia Pacific | 417 | 990 |
| | \$ 8,781 | \$ 11,616 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 12:- SELECTED STATEMENTS OF INCOME DATA

a. Financial income (expenses):

| | Year ended December 31, | | |
|--|-------------------------|----------|----------|
| | 2004 | 2005 | 2006 |
| Financial income: | | | |
| Interest on bank deposits | \$ 3,045 | \$ 3,426 | \$ 1,048 |
| Foreign currency translation differences, net | 784 | - | 892 |
| Amortization of premiums, accretion of discounts and interest on marketable debt securities, net | 852 | 2,856 | 5,620 |
| | 4,681 | 6,282 | 7,560 |
| Financial expenses: | | | |
| Interest and other bank charges | (116) | (70) | (138) |
| Foreign currency translation differences, net | - | (1,053) | - |
| | \$ 4,565 | \$ 5,159 | \$ 7,422 |

b. Net earnings per share:

The following table sets forth the calculation of basic and diluted net earnings (loss) per share:

| | Year ended December 31, | | |
|---|-------------------------|------------|------------|
| | 2004 | 2005 | 2006 |
| Numerator: | | | |
| Net income (loss) available to shareholders of Ordinary shares | \$ 13,780 | \$ 9,344 | \$ (1,280) |
| Denominator: | | | |
| Denominator for basic earnings (loss) per share - weighted average number of shares, net of treasury stock | 17,995,207 | 18,800,474 | 19,325,055 |
| Effect of dilutive securities: | | | |
| Employee stock options and ESPP | 1,809,689 | 1,271,718 | - |
| Denominator for diluted net earnings (loss) per share - adjusted weighted average number of Ordinary shares | 19,804,896 | 20,072,192 | 19,325,055 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 13:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Represents transactions and balances with other entities in which certain of the Company's shareholders have interest:

- a. The following related party balances are included in the balance sheets:

| | December 31, | |
|-------------------|--------------|----------|
| | 2005 | 2006 |
| Trade receivables | \$ 1,447 | \$ 1,452 |
| Trade payables | \$ - | \$ 68 |

- b. The following related party transactions are included in the statements of operations:

| | Year ended December 31, | | |
|--|-------------------------|----------|----------|
| | 2004 | 2005 | 2006 |
| Revenues | \$ 2,400 | \$ 3,111 | \$ 3,656 |
| Operating expenses, net and cost of revenues- primarily rental, sub-contractors and communications (1) | \$ 1,151 | \$ 1,309 | \$ 917 |
| Purchase of property and equipment | \$ 466 | \$ 377 | \$ 939 |

- (1) The Company leases office space and purchases other miscellaneous services from certain companies, which are considered to be related parties. In addition, the Company subleases part of the office space to related parties and provides certain services to related parties.

NOTE 14:- SUBSEQUENT EVENTS - unAudited

- a. in April 2007, the Company acquired Covelight Systems, Inc. ("Covelight"). The acquisition will be accounted under the provisions of SFAS No. 141, "Business Combinations" ("SFAS No. 141"). The total consideration for the acquisition will be up to \$ 16,000 out of which an amount of \$ 7,500 was paid in cash and an additional amount of up to \$ 8,500 is payable in cash contingent upon meeting sales performance targets by April 2008.

The Company is in the process of completing a Purchase Price Allocation ("PPA"). The Company expects that intangible assets will be derived from the acquisition.

- b. In respect of the petition for rehearing filed by the plaintiffs as discussed in Note 8b(1), on April 6, 2007, the Second Circuit denied the petition, but noted that the plaintiffs could ask the district court to certify a more narrow class than the one that was rejected. Plaintiffs have not yet moved to certify a class in the Company’s case.

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

RADWARE, INC.,

RADWARE, LTD.,

RADWARE DELAWARE CORP.,

COVELIGHT SYSTEMS, INC.,

INTERSOUTH PARTNERS VI, LP, as a Sellers Representative,

AURORA VENTURES IV, LLC, as a Sellers Representative,

AND CERTAIN NOTEHOLDERS AND STOCKHOLDERS OF
COVELIGHT SYSTEMS, INC.

DATED AS OF APRIL 25, 2007

Exhibits and Annexes

Exhibit A Form of Escrow Agreement
Exhibit B Form of Opinion of Counsel

AnnexA Flow of Funds

Schedule 7.01 Company Required Consents
Schedule 9.14 Knowledge

AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER, dated as of April 25, 2007 (this “Agreement”), by and among Radware, Inc., a New Jersey corporation (“Radware”), which is a wholly-owned subsidiary of Radware, Ltd., an Israeli corporation (“Parent”), Radware Delaware Corp., a Delaware corporation and a wholly-owned subsidiary of Radware (“Merger Sub”), Covelight Systems, Inc., a Delaware corporation (the “Company”), with respect to Article VIII and Sections 2.07, 2.08, 9.03, 9.06 and 9.16, Intersouth Partners VI, LP and Aurora Ventures IV, LLC, as Sellers Representatives (the “Sellers Representatives”) and other persons listed on the signature pages hereto as stockholders of the Company (collectively the “Company Stockholders”) and the holders of the Company’s convertible promissory notes (collectively the “Company Noteholders”).

WITNESSETH:

WHEREAS, each of Radware, Merger Sub and the Company has determined that it is advisable and in the best interests of its shareholders and stockholders, respectively, for the parties to enter into a business combination upon the terms and subject to the conditions set forth herein;

WHEREAS, in furtherance of such combination, the boards of directors of each of Merger Sub and the Company have approved, and the board of directors of Radware has authorized, the merger of Merger Sub with and into the Company (the “Merger”) in accordance with the applicable provisions of the General Corporation Law of the State of Delaware (the “Delaware Law”), and upon the terms and subject to the conditions set forth herein;

WHEREAS, the board of directors of the Company (the “Company Board”) has unanimously recommended that the stockholders of the Company approve and adopt this Agreement, the Merger and the other transactions contemplated hereby; and

WHEREAS, concurrently with the execution and delivery of this Agreement and as a condition to Radware’s willingness to enter into this Agreement, the requisite number of the Company’s stockholders, in accordance with the Delaware Law, have approved this Agreement and the transactions contemplated hereby (the “Approval”);

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained, and intending to be legally bound hereby, the parties hereto agree as follows:

ARTICLE I
DEFINITIONS

SECTION 1.01 Definitions. For purposes of this Agreement, the term:

“Additional Investor Incentive Agreement Amount” shall have the meaning set forth in Section 2.08(b).

“Additional Key Contributor Plan Amount” shall have the meaning set forth in Section 2.08(b).

“Additional Payment” shall have the meaning set forth in Section 2.08(a).

“affiliate” means, with respect to any person, any other person who, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the person specified.

“Agreement” shall have the meaning set forth in the preamble.

“Ancillary Agreements” means the Escrow Agreement and any note powers, stock powers and certificates required to be delivered under this Agreement.

“Approval” shall have the meaning set forth in the recitals.

“Audited Financial Statements” shall have the meaning set forth in Section 3.07.

“Basket Amount” shall have the meaning set forth in Section 8.04(a).

“BB&T Revenue” shall have the meaning set forth in Section 2.08(a).

“business day” means any day other than a Saturday, Sunday or other day on which banks in New York City are required or authorized to be closed.

“Certificate of Merger” shall have the meaning set forth in Section 2.02.

“Claim” shall have the meaning set forth in Section 8.03(b).

“Closing” shall have the meaning set forth in Section 2.01.

“Closing Date” shall have the meaning set forth in Section 2.01.

“Closing Date Purchase Price” means Seven Million Five Hundred Thousand Dollars (\$7,500,000) in cash.

“Code” means the Internal Revenue Code of 1986, as amended.

“Company” shall have the meaning set forth in the preamble.

“Company Board” shall have the meaning set forth in the recitals.

“Company By-Laws” shall have the meaning set forth in Section 3.02.

“Company Capital Stock” means, collectively, the Company Common Stock and the Company Preferred Stock.

“Company Certificate of Incorporation” shall have the meaning set forth in Section 3.02.

“Company Common Stock” means the common stock, par value \$0.001 per share, of the Company.

“Company Disclosure Schedule” shall have the meaning set forth in Article III.

“Company Material Adverse Effect” means a material adverse effect on or change to the business, operations, financial condition, assets, properties (including intangible properties) or liabilities of the Company, taken as a whole, excluding effects or changes (x) resulting from developments in worldwide, national or local conditions (political, economic or regulatory) that adversely affect enterprises or the Company’s industry generally and do not specifically relate to or have a materially disproportionate effect on the Company, taken as a whole or (y) resulting solely from the identity of the prospective purchaser of the Company or the announcement or pendency of the Merger.

“Company Noteholders” shall have the meaning set forth in the preamble.

“Company Option Plan” means the Company’s 2002 Stock Plan, as amended.

“Company Permits” shall have the meaning set forth in Section 3.06(b).

“Company Plan” or “Company Plans” shall have the meaning set forth in Section 3.11(a).

“Company Preferred Stock” means the Company’s preferred stock, par value \$0.001 per share, of the Company.

“Company Recipients” means the Company Stockholders and Company Noteholders.

“Company Required Consents” shall have the meaning set forth in Section 3.05(b).

“Company Software” shall have the meaning set forth in Section 3.17(l).

“Company Recipient Indemnitees” shall have the meaning set forth in Section 8.02.

“Company Stockholders” shall have the meaning set forth in the preamble.

“Confidential Information” shall have the meaning set forth in Section 6.01.

“Confidentiality Agreement” means the Mutual Nondisclosure Agreement dated as of November 9, 2006, as amended on January 18, 2007, between the Company and Parent.

“control” (including the terms “controlled by” and “under common control with”) means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities or securities or debt convertible into voting securities, by contract or otherwise.

“Copyrights” shall have the meaning set forth in Section 3.17(a)(i).

“Delaware Law” shall have the meaning set forth in the recitals.

“Domain Names” shall have the meaning set forth in Section 3.17(a)(iv).

“Earn Out Resolution Period” shall have the meaning set forth in Section 2.08(c).

“Effective Time” shall have the meaning set forth in Section 2.02.

“Election Notice” shall have the meaning set forth in Section 8.03(b)(i).

“Encumbrances” means any lien (other than mechanics’ liens), pledge, hypothecation, claim (other than infringement), charge, mortgage, security interest, encumbrance, prior assignment, interference, option, right of first refusal, preemptive right, community property interest or restriction of any nature whatsoever (including any restriction on the voting of any security, any restriction on the transfer of any security or other asset, any restriction on the receipt of any income derived from any asset, any restriction on the use of any asset and any restriction on the possession, exercise or transfer of any other attribute of ownership of any asset).

“Environmental Laws” means any applicable foreign, federal, state or local law, rule, regulation, ordinance, code, order or judgment (including any written judicial or administrative interpretations, guidances, directives, policy statements or opinions) relating to human health and safety or, injury to, or the pollution or protection of, the environment.

“Environmental Liabilities” means any claims, judgments, damages (including punitive damages), losses, penalties, fines, liabilities, Encumbrances, violations, costs and expenses (including attorneys’ and consultants’ fees) of investigation, remediation, monitoring or defense of any matter relating to human health, safety or the environment of whatever kind or nature by any party, entity or authority, that arise under Environmental Laws or that are incurred as a result of (i) the existence of Hazardous Substances in connection with the operation of the business of the Company, (ii) the violation of or non-compliance with any Environmental Laws or (iii) exposure to any Hazardous Substances.

“ERISA” shall have the meaning set forth in Section 3.11(a).

“ERISA Affiliate” shall have the meaning set forth in Section 3.11(a).

“Escrow Agent” shall have the meaning set forth in Section 2.09(a).

“Escrow Agreement” shall have the meaning set forth in Section 2.09(a).

“Escrow Amount” means Seven Hundred Fifty Thousand Dollars (\$750,000).

“Escrow Indemnity Account” shall have the meaning set forth in Section 2.09(a).

“Escrow Release Amount” shall have the meaning set forth in Section 2.09(a).

“Escrow Termination Date” shall have the meaning set forth in Section 2.09(a).

“Existing Options” means all options to purchase capital stock of the Company granted pursuant to the Company Option Plan or pursuant to any other arrangement adopted by the Company Board to provide options or other rights to purchase capital stock of the Company to directors, officers, employees or consultants of the Company.

“Extinguished Stock” shall have the meaning in Section 2.06(f).

“Financial Statements” shall have the meaning set forth in Section 3.07.

“First Anniversary Date” shall have the meaning set forth in Section 2.08(a).

“GAAP” means United States generally accepted accounting principles.

“Governmental Entity” means any foreign or United States federal, state or local governmental, administrative or regulatory authority, commission, body, agency, court or any judicial body or other similar authority.

“Hazardous Substances” means any chemicals, substances, materials or wastes regulated under any Environmental Law.

“Inflight and Percept Product Lines” means the Inflight and Percept product lines of the Surviving Corporation, including any product line extensions, improvements, derivative or additional products developed using the technology, intellectual property or engineering team of the Company as constituted prior to the Closing.

“Initial Investor Incentive Agreement Amount” shall have the meaning set forth in Section 2.07(b)(i).

“Initial Key Contributor Plan Amount” shall have the meaning set forth in Section 2.07(a)(i).

“Intellectual Property” shall have the meaning set forth in Section 3.17(a).

“Interim Escrow Release” shall have the meaning set forth in Section 2.09(a).

“Interim Financial Statements” shall have the meaning set forth in Section 3.07.

“Inventions” shall have the meaning set forth in Section 3.17(a)(vi).

“Investor Incentive Agreement” means the Covelight Systems, Inc. Amended and Restated Investor Incentive Bonus Agreement, dated as of February 20, 2007, by and among the Company and certain of the Company Stockholders.

“Investor Incentive Agreement Recipients” means the persons so designated as set forth on Annex A hereto, each of whom has been so designated in accordance with the terms of the Investor Incentive Agreement.

“IRS” shall have the meaning set forth in Section 3.11(d).

“JAMS” means Judicial Arbitration and Mediation Services.

“Key Contributor Plan” means the Amended and Restated Covelight Systems, Inc. Key Contributor Incentive Plan, effective as of August 15, 2006.

“Key Contributor Plan Participants” means the persons so designated as set forth on Annex A hereto, each of whom has been so designated in accordance with the terms of the Key Contributor Plan.

“Laws” shall have the meaning set forth in Section 3.06(a).

“License” shall have the meaning set forth in Section 3.17(c).

“Losses” shall have the meaning set forth in Section 8.01.

“Material Contracts” shall have the meaning set forth in Section 3.18.

“Merger Sub” shall have the meaning set forth in the preamble.

“Net Aggregate Merger Consideration” means the Closing Date Purchase Price, minus (x) the Transaction Expenses and the Initial Key Contributor Plan Amount and the Initial Investor Incentive Agreement Amount plus (y) the Additional Payment. The Noteholder Consideration and the Stockholder Consideration together shall equal the Net Aggregate Merger Consideration.

“Net Revenues” means the revenues recognized in accordance with GAAP from the sale, license, maintenance, support or other transactions associated with the Inflight and Percept Product Lines, minus (x) any credits, returns and allowances for bad or doubtful accounts and (y) an amount equal to all accounts receivable relating to the Inflight and Percept Product Lines which, as of the First Anniversary Date, are outstanding for over one hundred twenty (120) days; provided that for purposes of this Agreement, VSOE (vendor specific objective evidence) will not exceed 20% of price list per contract year and maintenance revenue will be recognized ratably over the life of the maintenance term.

“Neutral Firm” shall have the meaning set forth in Section 2.08(c).

“Noteholder Consideration” means the amounts paid to the holders of the Notes as set forth on Annex A.

“Notes” means the outstanding convertible promissory notes in the aggregate principal amount of \$4,125,000 issued by the Company in favor of the Company Noteholders.

“Notice Date” shall have the meaning set forth in Section 2.08(b).

“Parent” shall have the meaning set forth in the preamble.

“Patents” shall have the meaning set forth in Section 3.17(a)(ii).

“Payment Calculator” shall have the meaning set forth in Section 2.13.

“Permitted Encumbrances” shall have the meaning set forth in Section 3.19.

“person” means a natural person, a governmental entity, agency or representative (at any level of government), a corporation, partnership, joint venture or other association, as context requires.

“Pro Rata Interest” means, with respect to a Company Recipient, a fraction, the numerator of which is the aggregate portion of the Net Aggregate Merger Consideration that such holder receives hereunder and the denominator of which is the Net Aggregate Merger Consideration received by all Company Recipients.

“Proceeding” means any claim, action, suit, investigation, arbitration, litigation or other proceeding.

“PTO” shall have the meaning set forth in Section 3.17(g)(i).

“Radware” shall have the meaning set forth in the preamble.

“Radware Disclosure Schedule” shall have the meaning set forth in Article V.

“Radware Indemnitees” shall have the meaning set forth in Section 8.01.

“Related Party” shall have the meaning set forth in Section 3.21(a).

“Rights Agreements” shall have the meaning set forth in Section 4.01.

“Sellers Representative” shall have the meaning set forth in Section 9.16(a).

“Software” shall have the meaning set forth in Section 3.17(a)(vii).

“Stockholder Consideration” means the amounts to be paid to the Company’s stockholders set forth on Annex A.

“subsidiary” or “subsidiaries” of any person means any corporation, partnership, joint venture or other legal entity of which such person (either alone or through or together with any other subsidiary) owns, directly or indirectly, more than 50% of the stock or other equity interests the holders of which are generally entitled to vote for the election of the board of directors or other governing body of such corporation or other legal entity.

“Surviving Corporation” shall have the meaning set forth in Section 2.01.

“Surviving Corporation Common Stock” shall have the meaning set forth in Section 2.06(b).

“Tax” or “Taxes” means (i) all taxes, including, but not limited to, income (whether net or gross), excise, real or personal property, sales, transfer, gains, gross receipts, occupation, privilege, payroll, wage, unemployment, workers’ compensation, social security, occupation, use, value added, capital, gross receipts, franchise, license, severance, stamp, premium, windfall profits, environmental (including taxes under Code Sec. 59A), capital stock, profits, withholding, disability, registration, customs duties, alternative or add-on minimum, estimated or other tax of any kind whatsoever (whether disputed or not) imposed by any Tax Authority, including any related charges, fees, interest, penalties, additions to tax or other assessments imposed with respect thereto and (ii) any liability of the Company for the payment of amounts of the type described in clause (i) as a result of any obligation of the Company under any tax sharing or tax indemnity agreement, provision or arrangement, whether formal or informal or under Treasury Regulations § 1.1502-6 or similar provisions under state, local or non-U.S. law.

“Tax Authority” means any federal, national, foreign, state, municipal or other local government, or any subdivision, agency, commission or authority thereof, or any quasi-governmental body or other authority exercising any regulatory authority with respect to Taxes.

“Tax Proceeding” means any audit or investigation, other administrative proceeding or judicial proceeding involving Taxes.

“Tax Reserve” means, with respect to the Company, (i) the amount of current Taxes (excluding any provision for deferred Taxes) reflected as a liability on the Unaudited Balance Sheet, as defined in Section 3.07, and (ii) any additional Taxes accrued in the ordinary course of business between the date of the Unaudited Balance Sheet and the close of the Closing Date, to the extent the Taxes referred to in clause (i) or clause (ii) have not been paid prior to the Closing Date.

“Tax Returns” means all returns, reports, estimates, information returns and statements (including any related or supporting information) filed or to be filed with any Tax Authority in connection with the determination, assessment, collection or administration of any Taxes.

“Third-Party Claims” shall have the meaning set forth in Section 8.03(b).

“Third-Party Software” shall have the meaning set forth in Section 3.17(l).

“Timely Dispute Notice” shall have the meaning set forth in Section 2.08(b).

“Trade Secrets” shall have the meaning set forth in Section 3.17(a)(v).

“Trademarks” shall have the meaning set forth in Section 3.17(a)(iii).

“Transaction Expenses” means the amount of all unpaid attorneys’, investment bankers’ and accountants’ fees and expenses and other similar fees and expenses incurred or to be incurred by the Company in connection with the transactions contemplated by this Agreement. All Transaction Expenses, including the name of the party and the amount due as of the Closing shall be set forth on Annex A attached hereto.

“Treasury Shares” shall have the meaning set forth in Section 2.06(a).

“Treasury Regulations” mean the final Regulations and Temporary Regulations promulgated under the Code, as currently in effect, as such regulations may hereafter be amended from time to time (including corresponding provisions of succeeding regulations).

“Unaudited Balance Sheet” shall have the meaning set forth in Section 3.07.

ARTICLE II
THE MERGER

SECTION 2.01 The Merger. Upon the terms and subject to the conditions set forth in this Agreement and the Certificate of Merger, and in accordance with the Delaware Law, at the Effective Time, Merger Sub shall be merged with and into the Company. As a result of the Merger, the separate corporate existence of Merger Sub shall cease and the Company shall continue as the surviving corporation of the Merger (the “Surviving Corporation”) and shall succeed to and assume all the rights and obligations of Merger Sub in accordance with the Delaware Law. Subject to the terms of this Agreement, the consummation of the Merger (the “Closing”) will take place as promptly as practicable (and in any event within two (2) business days) after delivery of the items set forth in Article VII, at the offices of Kramer Levin Naftalis & Frankel LLP, 1177 Avenue of the Americas, New York, New York 10036, unless another date, time or place is agreed to in writing by Radware and the Company (the “Closing Date”).

SECTION 2.02 Effective Time. On the Closing Date, the parties hereto shall file a certificate of merger (the “Certificate of Merger”) with the Secretary of State of the State of Delaware, in such form as required by, and executed in accordance with the relevant provisions of, the Delaware Law. The Merger shall become effective at such time as the Certificate of Merger is duly filed with such Secretary of State, or at such other time as Radware and the Company shall agree and specify in the Certificate of Merger (the time the Merger becomes effective being the “Effective Time”).

SECTION 2.03 Effect of the Merger. At the Effective Time, the effect of the Merger shall be as provided in this Agreement, the Certificate of Merger and the applicable provisions of the Delaware Law. Without limiting the generality of the foregoing, at the Effective Time all the property, goodwill, rights, privileges, powers and franchises of the Company and Merger Sub shall vest in the Surviving Corporation, and all debts, liabilities and duties of the Company and Merger Sub shall become the debts, liabilities and duties of the Surviving Corporation.

SECTION 2.04 Certificate of Incorporation; By-Laws.

- (a) At the Effective Time, the certificate of incorporation of Merger Sub shall be the certificate of incorporation of the Surviving Corporation.
- (b) At the Effective Time, the by-laws of Merger Sub shall be the by-laws of the Surviving Corporation.

SECTION 2.05 Directors and Officers. The directors of Merger Sub immediately prior to the Effective Time shall be the initial directors of the Surviving Corporation and the persons designated by Radware shall be the initial officers of the Surviving Corporation.

SECTION 2.06 Effect on Capital Stock Payment. At the Effective Time, by virtue of the Merger and without any action on the part of any Company Stockholder or the holder of any shares of the capital stock of Merger Sub:

(a) Company Treasury Shares. Each share of Company Common Stock held by the Company as treasury stock and each share of Company Preferred Stock held by the Company as treasury stock immediately prior to the Effective Time (collectively, "Treasury Shares") shall automatically be canceled and retired and cease to exist, and no consideration or payment shall be delivered therefor or in respect thereof.

(b) Capital Stock of Merger Sub. Each share of capital stock of Merger Sub issued and outstanding immediately prior to the Effective Time shall be converted into one share of common stock, par value \$0.001 per share, of the Surviving Corporation ("Surviving Corporation Common Stock"), with the same rights, powers and privileges as the shares so converted and shall constitute the only outstanding shares of capital stock of the Surviving Corporation. Each stock certificate of Merger Sub evidencing ownership of any such shares shall remain outstanding and evidence ownership of shares of Surviving Corporation Common Stock.

(c) Existing Options. Radware is not assuming any Existing Options in the Merger, and all of the Existing Options shall be cancelled and terminated, and be of no further force or effect from and after the Closing without payment of consideration therefor.

(d) Derivative Securities. Each Company Recipient agrees that any derivative securities of the Company it holds other than the Notes and the Company Preferred Stock (including but not limited to warrants) shall be cancelled and terminated and be of no further force or effect from and after the Closing without payment of consideration therefor.

(e) Notes. Title to each of the Notes will be transferred to Radware upon Closing in exchange for the Noteholder Consideration, free and clear of all Encumbrances.

(f) Outstanding Company Common Stock and Company Preferred Stock. Each share of Company Common Stock issued and outstanding immediately prior to the Effective Time and each share of Company Preferred Stock issued and outstanding immediately prior to the Effective Time (other than Treasury Shares) shall be cancelled and extinguished (the "Extinguished Stock") and thereafter shall represent the right to receive the Stockholder Consideration.

(g) Payment of Closing Purchase Price. On the Closing Date, Radware will pay the Closing Date Purchase Price as set forth on Annex A by check or wire transfer of immediately available U.S. funds.

(h) Capital Transaction Nature of the Purchase of the Notes. Each party hereto agrees that Radware is purchasing the Notes and will treat such purchase as a capital transaction.

SECTION 2.07 Effect on Incentive Plans.

(a) Key Contributor Plan.

(i) On the Closing Date, pursuant to the Key Contributor Plan, each of the Key Contributor Plan Participants shall receive the amounts set forth opposite his, her or its name on Annex A attached hereto (collectively, the “Initial Key Contributor Plan Amount”), which amounts Radware shall pay to the Key Contributor Plan Participants.

(ii) If an Additional Payment is payable to the Company Recipients pursuant to Section 2.08(d), Radware shall pay the Additional Key Contributor Plan Amount to the Key Contributor Plan Participants, allocated as set forth on Annex A, at the same time that the Additional Payment is required to be made pursuant to Section 2.08, and the amount of the Additional Payment shall be net of the Additional Key Contributor Plan Amount. In the event any Additional Key Contributor Plan Amount is undesignated as to the recipient at the time of payment, the Sellers Representatives shall provide Radware with the names and amounts of the recipients.

(b) Investor Incentive Agreement.

(i) On the Closing Date, pursuant to the Investor Incentive Agreement, each of the Investor Incentive Agreement Recipients shall receive the amounts set forth opposite his, her or its name on Annex A attached hereto (collectively, the “Initial Investor Incentive Agreement Amount”), which amounts Radware shall pay to the Investor Incentive Agreement Recipients.

(ii) If an Additional Payment is payable to the Company Recipients pursuant to Section 2.08(d), Radware shall pay the Additional Investor Incentive Agreement Amount to the Investor Incentive Agreement Recipients, allocated as set forth on Annex A, at the same time that the Additional Payment is required to be made pursuant to Section 2.08, and the amount of the Additional Payment shall be net of the Additional Investor Incentive Agreement Amount. In the event any Additional Investor Incentive Agreement Amount is undesignated as to the recipient at the time of payment, the Sellers Representatives shall provide Radware with the names and amounts of the recipients.

SECTION 2.08 Additional Payment.

(a) Additional Payment. Subject to the terms and conditions set forth in this Section 2.08 and this Agreement, Radware shall make a payment to the Company Recipients as follows: a one-time cash payment (the “Additional Payment”) equal to that positive number representing the sum of (i) the product of two multiplied by the Net Revenues recognized by the Inflight and Percept Product Lines during the twelve (12) months beginning April 1, 2007 and ending March 31, 2008 (the “First Anniversary Date”) (including Net Revenues recognized during April and prior to Closing), minus (ii) Seven Million Five Hundred Thousand Dollars (\$7,500,000); provided that (x) the Additional Payment shall be reduced by the Additional Key Contributor Plan Amount and the Additional Investor Incentive Agreement Amount, respectively and (y) the sum of (1) the Additional Payment, (2) the Additional Key Contributor Plan Amount and (3) the Additional Investor Incentive Agreement Amount shall not exceed Eight Million Five Hundred Thousand Dollars (\$8,500,000). The Company has sold certain products to BB&T Corporation and has received payment but has not yet recognized the revenues under GAAP for accounting purposes (the “BB&T Revenue”). In the event that (i) Parent does not recognize the BB&T Revenue as part of its net revenues for accounting purposes during the period beginning on the date hereof and ending March 31, 2008, then the BB&T Revenue shall not constitute Net Revenues and (ii) Parent does recognize all or part of the BB&T Revenue as part of its net revenues for accounting purposes during the period beginning on the date hereof and ending March 31, 2008, then the BB&T Revenue, to the extent so recognized by Parent, shall constitute Net Revenues.

(b) Additional Payment and Dispute Notice by the Company Recipients. Within forty five (45) days of the First Anniversary Date, Radware shall provide the Sellers Representatives with its calculation of the Additional Payment, the additional amounts that shall be payable to the Key Contributor Plan Participants pursuant to the terms of the Key Contributor Plan (collectively, the “Additional Key Contributor Plan Amount”) and the additional amounts that shall be payable to the Investor Incentive Agreement Recipients pursuant to the terms of the Investor Incentive Agreement (collectively, the “Additional Investor Incentive Agreement Amount”) (the date on which such notice is delivered, the “Notice Date”). Unless both Sellers Representatives deliver a Dispute Notice (a “Timely Dispute Notice”) to Radware on or prior to thirty (30) days following the Notice Date (the “Dispute Notice Date”), the Company Recipients shall be deemed to have accepted and agreed to Radware’s determination of the Additional Payment, the Additional Key Contributor Plan Amount and the Additional Investor Incentive Agreement Amount, if any, that is payable to the Company Recipients, the Key Contributor Plan Participants and the Investor Incentive Agreement Recipients, respectively.

(c) Disputes. If the Sellers Representatives timely provide a Dispute Notice to Radware, the representatives of Radware and both Sellers Representatives shall, within thirty (30) days following the date of the Dispute Notice (the “Earn Out Resolution Period”), attempt in good faith to resolve their differences and any resolution by them that is agreed by the parties in writing shall be final, binding and conclusive. In connection with any such dispute, each party will cooperate with the other party to attempt to resolve such dispute including making available to such other parties personnel, books and records, material and other information reasonably requested for making determinations as to the dispute and related computations. If at the conclusion of the Earn Out Resolution Period there are amounts remaining in dispute, then all amounts remaining in dispute shall be submitted for resolution to a recognizable, reputable and impartial certified public accounting firm that is mutually acceptable to Radware and both Sellers Representatives (the “Neutral Firm”). If Radware and both Sellers Representatives cannot agree upon a Neutral Firm within ten (10) days, a mediator selected by JAMS at the request of the parties shall choose a recognized, reputable, and impartial certified public accounting firm to act as the Neutral Firm. The Neutral Firm shall promptly resolve the amounts remaining in dispute between the parties and shall, within thirty (30) days of its engagement, deliver its determination of the amounts remaining in dispute in writing to Radware and the Sellers Representatives, which determination shall be final, binding and conclusive. The fees and expenses of the Neutral Firm shall be shared by Radware, on the one hand, and the Company Recipients, on the other hand, in inverse proportion to the relative amounts of the disputed amounts determined in favor of Radware, on the one hand, and the Company Recipients, on the other hand, respectively.

(d) Payment of Additional Payment. Within ten (10) days of the final determination of the amounts of the Additional Payment, the Additional Key Contributor Plan Amount and the Additional Investor Incentive Agreement Amount in accordance with this Section 2.08, Radware shall, in reliance on certifications received from all of the Company Recipients, the Key Contributor Plan Participants and the Investor Incentive Agreement Recipients, (i) pay the Company Recipients the Additional Payment pursuant to Section 2.06(f); (ii) pay the Key Contributor Plan Participants the Additional Key Contributor Plan Amount pursuant to Section 2.07(a)(ii); and (iii) pay the Investor Incentive Agreement Recipients the Additional Investor Incentive Agreement Amount pursuant to Section 2.07(b)(ii). Upon payment of these amounts, Radware shall receive a binding acknowledgement executed by each of the Company Recipients, the Key Contributor Plan Participants and the Investor Incentive Agreement Recipients, respectively, acknowledging that they have each received any and all proceeds that they are entitled to pursuant to this Agreement. Notwithstanding the foregoing, in the event that amounts are released from escrow pursuant to Section 2.09(a), an amount equal to the Escrow Release Amount shall be withheld from the Additional Payment until the later of (x) the Escrow Termination Date and (y) if at the Escrow Termination Date there are any then pending and unresolved claims for indemnification under Article VIII, then the final resolution of such claims (to the extent of such claims) and the withheld amounts shall be applied in accordance with Article VIII.

(e) Price Protection. Radware and Parent shall adhere to their ordinary course pricing policies in the sale of any product in the Inflight or Percept Product Line, and will not alter their pricing practices in order to reduce the amount of the Additional Payment due under this Agreement. In addition, Radware and Parent agree that in the event of the sale of any Radware or Parent products bundled with a product in the Inflight or Percept Product Line, the percentage of list price discount applied to the product in the Inflight or Percept Product Line will not exceed the percentage of list price discount applied to the Radware or Parent product.

SECTION 2.09 Escrow Accounts.

(a) At the Effective Time, Radware shall deliver from the Net Aggregate Merger Consideration to the escrow agent (the “Escrow Agent”), (i) under the escrow agreement dated the Closing Date, in substantially the form attached as Exhibit A hereto (the “Escrow Agreement”), the Escrow Amount to be held in an escrow account (the “Escrow Indemnity Account”) in accordance with the terms of the Escrow Agreement. The Escrow Amount will be available to satisfy claims for Losses made by the Radware Indemnitees pursuant and subject to Article VIII hereof. Unless all of the Escrow Amount is released earlier to a Radware Indemnatee pursuant to the Escrow Agreement, the Escrow Amount (or any portion thereof remaining in the Escrow Indemnity Account) will be held by the Escrow Agent until the first anniversary of the Closing Date (the “Escrow Termination Date”). Upon the Escrow Termination Date, Radware shall cause any amount remaining in the Escrow Indemnity Account at such time to be paid to the Company Recipients in accordance with Annex A. Notwithstanding the foregoing,

(x) to the extent that any then pending and unresolved claims for indemnification under Article VIII exist for which Radware has timely provided notice in accordance with Section 8.04(d), the funds reasonably necessary to satisfy such claims will be retained by the Escrow Agent pursuant to the terms of the Escrow Agreement until such claims are resolved in accordance with the terms thereof and the terms of this Agreement; and

(y) (1) on a date that is forty five (45) days following the six (6) month anniversary of the Closing Date, the parties shall release from escrow, for payment in accordance with Annex A, an amount, if any, equal to seventy five percent (75%) of the Additional Payment that is anticipated to be due based on the revenues recognized from the Inflight and Precept Product Lines during the six (6) months following the Closing Date as set forth in the quarterly revenue update delivered by Radware pursuant to Section 9.17 (such amount, if any, the “Interim Escrow Release”) and (2) following the final determination of the Additional Payment pursuant to Section 2.08, the parties shall release from escrow, for payment in accordance with Annex A, an amount, if any, equal to the difference between (i) Additional Payment finally determined to be due pursuant to Section 2.08 and (ii) the Interim Escrow Release (such amount, together with the Interim Escrow Release, the “Escrow Release Amount”); provided in each of the cases of clauses (1) and (2), that there are not outstanding at such time and pending any unresolved claims for indemnification under Article VIII.

(b) On or immediately prior to the Closing Date, the Company shall deliver to Radware a statement of all Transaction Expenses, including final invoices for any hourly or similar unfixed Transaction Expenses being presented by vendors immediately prior to Closing. At or as soon as practicable after the Effective Time, Radware shall pay the Transaction Expenses (the aggregate amount of which shall reduce the Closing Date Purchase Price) to the parties to whom such Transaction Expenses are payable.

SECTION 2.10 Surrender.

(a) Each holder of Notes or shares of Company Common Stock or Company Preferred Stock shall, at Closing, surrender to Radware the Notes or applicable certificate or certificates representing such shares of Company Common Stock or Company Preferred duly endorsed for transfer or accompanied by appropriate undated note powers or stock powers, as the case may be, transferring such securities to Radware.

(b) After the Effective Time, there shall be no further registration of transfers of shares of Company Capital Stock outstanding prior to the Effective Time. If, after the Effective Time, certificates representing shares of Company Capital Stock outstanding prior to the Effective Time are presented to the Surviving Corporation, they shall be cancelled and exchanged for the applicable Stockholder Consideration, and in accordance with the procedures set forth in this Agreement.

(c) If any of the Notes or Company Common Stock or Company Preferred Stock certificates shall have been lost, stolen or destroyed, the holder thereof shall deliver in exchange for such lost, stolen or destroyed certificates, upon the making of an affidavit of that fact by the holder thereof, the applicable portion of such holder’s Net Aggregate Merger Consideration; provided, however, that Radware may, in its discretion and as a condition precedent to the issuance and delivery thereof, require the owner of such lost, stolen or destroyed certificates to deliver a reasonable and customary indemnity as it may reasonably direct against any claim that may be made against Radware or the Company with respect to such certificates alleged to have been lost, stolen or destroyed.

(d) To the extent permitted by applicable Law, none of Radware, Parent, Merger Sub, the Company or the Surviving Corporation shall be liable to any holder of Notes, Company Common Stock or Company Preferred Stock for any portion of the Net Aggregate Merger Consideration required to be delivered to a public official pursuant to any applicable abandoned property, escheat or similar law.

(e) Each of Radware and the Surviving Corporation shall be entitled to deduct and withhold from the portion of the Net Aggregate Merger Consideration otherwise payable to Company Stockholders, Company Noteholders, Investor Incentive Agreement Recipients and Key Contributor Plan Participants such amounts as it is required to deduct and withhold with respect to the making of such payment under the Code or any provision of state, local, provincial or foreign tax law. To the extent that amounts are so withheld, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to the holder of Company Preferred Stock in respect of which such deduction and withholding was made.

SECTION 2.11 Dissenting Shares. Each Company Stockholder will have waived any appraisal rights under Delaware law in connection with the Merger prior to the Closing Date.

SECTION 2.12 Further Action. If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Company and Merger Sub, the officers and directors of the Company and Merger Sub are fully authorized in the name of their respective corporations or otherwise to take, and will take, all such lawful and necessary action.

SECTION 2.13 Annex A. The hardcopy version of Annex A attached hereto reflects payment of the maximum Additional Payment and no claims against the Escrow Amount. The Company shall attach a sealed envelope to each copy of this Agreement containing the spreadsheets used to generate Annex A (the “Payment Calculator”) and at the appropriate time shall input the actual Additional Payment and the amount released from the escrow to generate a final revised Annex A.

ARTICLE III
REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company represents and warrants to Radware, Parent and Merger Sub as of the date hereof that the statements contained in this Article III are true and correct, except as set forth in the disclosure schedule delivered by the Company to Radware on the date hereof (the “Company Disclosure Schedule”). The Company Disclosure Schedule shall be arranged in paragraphs corresponding to the numbered and lettered paragraphs in this Article III and the disclosure in any paragraph shall qualify other paragraphs in this Article III only to the extent that it is specifically indicated in such paragraph.

SECTION 3.01 Organization and Qualification; Subsidiaries. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware and has the requisite corporate power and authority necessary to own, lease and operate the properties it owns, leases or operates and to carry on its business as it is now being conducted. The Company does not have any subsidiaries. The Company is duly qualified or licensed as a foreign corporation to do business, and is in good standing, in each jurisdiction where the character of its properties owned, leased or operated by it or the nature of its activities makes such qualification or licensing necessary, except for such failures to be so duly qualified or licensed and in good standing that would not have, individually or in the aggregate, a Company Material Adverse Effect. Each jurisdiction in which the Company is so qualified or licensed is set forth in Section 3.01 of the Company Disclosure Schedule. The Company does not own, directly or indirectly, any equity or similar interest in, or any interest convertible into or exchangeable or exercisable for any equity or similar interest in, any corporation, partnership, joint venture, limited liability company or other business association or entity, whether incorporated or unincorporated.

SECTION 3.02 Certificate of Incorporation and By-Laws. The Company has previously furnished to Radware a complete and correct copy of its Amended and Restated Certificate of Incorporation (as amended and restated, the "Company Certificate of Incorporation") and By-Laws (the "Company By-Laws"), each as amended to date. Such Company Certificate of Incorporation and Company By-Laws are in full force and effect. The Company is not in violation of any of the provisions of the Company Certificate of Incorporation or Company By-Laws.

SECTION 3.03 Capitalization.

(a) The authorized capital stock of the Company consists of 8,000,000 shares of Company Common Stock and 4,275,627 shares of Company Preferred Stock, par value \$0.001 per share. As of the date hereof, (i) 1,307,652 shares of Company Common Stock are issued and outstanding, (ii) 938,733 shares of Company Common Stock are reserved for issuance pursuant to outstanding Existing Options, (iii) 100,000 shares of Company Common Stock are reserved for issuance pursuant to outstanding warrants, and (iv) 4,275,627 shares of Company Preferred Stock are issued and outstanding. As of the date hereof, Notes in the aggregate principal amount of \$4,125,000 are issued and outstanding. As of the date hereof, there are no other shares of Company Capital Stock issued and outstanding or reserved for future issuance.

All of the issued and outstanding shares of Company Capital Stock are duly authorized, validly issued, fully paid and non-assessable. None of the issued and outstanding shares of Company Capital Stock has been issued in violation of the Company Certificate of Incorporation, any applicable federal or state Law or any preemptive rights or rights to subscribe for or purchase securities. Except as set forth in the Rights Agreements, this Section 3.03 or Section 3.11 hereof, there are no options, convertible notes, warrants, calls or preemptive rights relating to the issued or unissued capital stock of the Company or obligating the Company to issue, transfer, deliver or sell, or cause to be issued, transferred, delivered or sold, any shares of capital stock of, or any securities directly or indirectly convertible into or exercisable or exchangeable for any shares of capital stock of, the Company. The Company does not have issued and outstanding any stock appreciation rights, phantom stock, performance based rights or similar rights or obligations. There are no obligations, contingent or otherwise, of the Company to repurchase, redeem or otherwise acquire any shares of capital stock of the Company or to provide funds to or make any investment (in the form of a loan, capital contribution or otherwise) in the Company or any other entity. Except as set forth in the Rights Agreements, there are no voting trusts, proxies or other agreements or understandings with respect to any Company Capital Stock to which the Company or, to the knowledge of the Company, any other person is a party or by which the Company or any such other person is bound.

(b) Section 3.03(b) of the Company Disclosure Schedule lists (i) all holders of Company Capital Stock as of the date hereof, as well as the number, class and series of shares of Company Capital Stock held by each such holder and (ii) all holders of Notes.

(c) Section 3.03(c) of the Company Disclosure Schedule sets forth a true and complete list of each current or former employee, officer, director or consultant of the Company or other person who holds an Existing Option as of the date hereof, together with the number of shares of Company Common Stock subject to such Existing Option. As of the Closing Date, in accordance with the terms and conditions of the Company Option Plan, all of the Existing Options shall be cancelled and terminated, and be of no further force or effect from and after the Closing.

(d) Except for accrued dividends on the Company Preferred Stock set forth in Section 3.03(d) of the Company Disclosure Schedule, the Company has never declared, nor is there accrued, any dividend or other distribution with respect to any class or series of Company Capital Stock.

(e) Upon payment of the Closing Date Purchase Price as provided for in this Agreement, the Company Stockholders, Company Noteholders and the optionholders of the Company will have no further right or claim against the Company, Radware, Merger Sub or the Surviving Corporation or any of their respective directors, officers, employees, agents or advisors, for any amount owing to such noteholders, stockholders or optionholders (i) in their capacity as noteholders, stockholders and optionholders of the Company, (ii) pursuant to the Company Certificate of Incorporation or Company By-Laws or the Delaware Law, (iii) relating to or in connection with this Agreement, the Merger or the other transactions contemplated hereby or (iv) pursuant to the Key Contributor Plan or the Investor Incentive Agreement, other than the right to receive the Escrow Amount, the Additional Payment, the Additional Key Contributor Amount and the Additional Investor Incentive Amount in accordance with this Agreement.

SECTION 3.04 Authority Relative to this Agreement; Corporate Action. (a) The Company has all necessary corporate power and authority to execute and deliver this Agreement and each of the Ancillary Agreements to which it is a party and to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by the Company and the consummation by the Company of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary corporate action on the part of the Company. This Agreement and the Ancillary Agreements to which the Company is a party have been duly and validly executed and delivered by the Company and, assuming the due authorization, execution and delivery of this Agreement and the Ancillary Agreements by each of the other parties hereto and thereto, constitutes, or, in the case of the Ancillary Agreements to which it is a party have been or, if executed after the date hereof and at or prior to the Effective Time, will constitute, legal, valid and binding obligations of the Company, enforceable against the Company in accordance with their respective terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles regardless of whether such enforceability is considered in a proceeding at law or in equity.

(b) Necessary Actions; Notice. The Company has taken all necessary steps so that all corporate actions, proceedings, instruments, and documents required to carry out the transactions contemplated hereby or incidental hereto and all other related legal matters are reasonably satisfactory to, and has furnished Radware’s counsel with, such certified copies of such corporate actions and proceedings and such other instruments and documents as Radware’s counsel shall have reasonably requested.

(c) The Second Global Amendment to Secured Convertible Promissory Notes, entered into as of April 19, 2007, by and among the Company and the Company Noteholders, has been duly and validly executed and delivered by the parties thereto and constitutes the legal, valid and binding obligation of the Company, enforceable in accordance with its terms.

SECTION 3.05 No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by the Company do not, and the performance of this Agreement and the Ancillary Agreements to which it is a party by the Company and the consummation by the Company of the transactions contemplated hereby and thereby will not, (i) conflict with or violate the Company Certificate of Incorporation or Company By-Laws, (ii) conflict with or violate any Law applicable to the Company or by which any of its properties or operations is bound or affected, (iii) conflict with, result in any breach of, or constitute a default (or an event that with notice or lapse of time or both would become a default) under, or impair the Company’s rights or alter the rights or obligations of any third party under, or give to others any rights of termination, amendment, acceleration or cancellation of, or result in the creation of an Encumbrance on any of the properties or assets of the Company pursuant to, any material note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Company is a party or by which the Company, or any of its properties, is bound, except, in the cases of clauses (ii) and (iii), as would not have a Company Material Adverse Effect.

(b) Except as set forth in Section 3.05(b) of the Company Disclosure Schedule (the “Company Required Consents”) the execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by the Company do not, and the performance of this Agreement and the Ancillary Agreements to which it is a party by the Company and the consummation by the Company of the transactions contemplated hereby and thereby will not, require the Company to obtain any waiver, consent, approval, authorization or permit of, or make any filing with or notification to, any Governmental Entity or other third party, except (i) the filing of the Certificate of Merger as required by the Delaware Law and (ii) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not prevent or delay consummation of the Merger, or otherwise prevent or delay the Company from performing its obligations under this Agreement.

SECTION 3.06 Compliance, Permits.

(a) The Company and its properties and operations, are and since inception have been in compliance with all foreign, federal, state and local statutes, laws, rules, regulations, ordinances, orders, judgments, decrees and other authorizations and approvals of Governmental Entities (collectively, "Laws"), applicable to the Company or by which any of its properties or operations is bound except as would not have a Company Material Adverse Effect. The Company has not received any notice or other communication (whether written or oral) from any Governmental Entity regarding any actual, alleged, possible or potential violation of, or any failure to comply with, any Law.

(b) The Company possesses all permits, licenses, consents, franchises, orders, approvals, certifications, registrations and authorizations from Governmental Entities necessary to enable it to continue to own, lease, operate and use its assets and properties and conduct its business as presently conducted (collectively, the "Company Permits") except as would not have a Company Material Adverse Effect. All of the Company Permits are valid and in full force and effect, and the Company has no reason to believe that any Governmental Entity will revoke, cancel, rescind, refuse to renew in the ordinary course or modify any of the Company Permits, nor is any proceeding pending for any such purpose except as would not have a Company Material Adverse Effect. The Company is in compliance in all material respects with the terms of the Company Permits and with all material requirements, standards and procedures of the Governmental Entities that issued them, and with any limitation on any Company Permit.

SECTION 3.07 Financial Statements. Attached as Section 3.07 of the Company Disclosure Schedule are (i) the unaudited consolidated balance sheet of the Company as of March 31, 2007 (the "Unaudited Balance Sheet") and the related consolidated statements of income, cash flows and changes in stockholders' equity for the ten (10) months then ended (the "Interim Financial Statements"), and (ii) the audited consolidated balance sheet of the Company as of May 31, 2006 and the related consolidated statements of income, cash flows and changes in stockholders' equity for the year then ended, accompanied by the report of the Company's independent public accountants thereon (the "Audited Financial Statements" and, together with the Interim Financial Statements, the "Financial Statements"). Each of the Financial Statements (including, in each case, the related notes thereto) was prepared in accordance with the books and records of the Company and in accordance with GAAP applied on a consistent basis throughout the periods involved (except as may be indicated therein or in the notes thereto) and is true and correct, and each fairly presents in all material respects the consolidated financial position of the Company as at the respective dates thereof and the consolidated results of its operations and cash flows for the periods indicated, except that the Interim Financial Statements are subject to normal and recurring year-end adjustments which will not be material in amount and such Interim Financial Statements and may not contain all notes required by GAAP.

SECTION 3.08 Absence of Certain Changes or Events. Since the date of the Unaudited Balance Sheet, the Company has conducted its business in the ordinary course consistent with past practice and there has not been: (i) any Company Material Adverse Effect; (ii) any damage to, destruction or loss of any material assets of the Company (whether or not covered by insurance); (iii) any revaluation by the Company of any of its assets, including, without limitation, writing down the value of capitalized software or inventory or writing off notes or accounts receivable, other than, in each case, in the ordinary course of business; (iv) any transaction, commitment, contract or agreement entered into by the Company requiring the Company to pay, or any relinquishment by the Company of any contract or other right, in any case having a value of or involving aggregate payments or value in excess of Twenty Five Thousand Dollars (\$25,000) other than in the ordinary course of business; (v) any material adverse change in any customer, supplier, licensee or licensor relationship, including any cancellation, termination or adverse modification or, threatened cancellation, termination or adverse modification of any such relationship; or (vi) any grant of any severance or termination pay to any Company employee or consultant or any increase in the rate or terms of compensation payable or to become payable by the Company to any of its employees or consultants or any increase in the rate or terms of any bonus, pension or other employee benefit plan covering any of the Company’s employees (including any new or amended employment, consulting or other compensation agreement).

SECTION 3.09 No Undisclosed Liabilities. The Company does not have any liabilities (absolute, accrued, contingent or otherwise) whether or not required to be disclosed in the Financial Statements, except liabilities (i) provided for in the Unaudited Balance Sheet, (ii) incurred in the ordinary course of business and consistent with past practice and that could not reasonably be expected to have a Company Material Adverse Effect, or (iii) set forth in Section 3.09 of the Company Disclosure Schedule.

SECTION 3.10 Absence of Litigation. Except as set forth in Section 3.10 of the Company Disclosure Schedule, there are no claims, actions, suits, proceedings or investigations pending or, to the knowledge of the Company, threatened against the Company, or any properties of the Company, or, to the knowledge of the Company, against any officers, directors or employees of the Company in their capacity as such, before any arbitrator or arbitral forum or tribunal or Governmental Entity. None of the Company, any of its properties or, to the knowledge of the Company, any of the Company’s officers, directors or employees in their capacity as such is subject or party to any judgment, order, decree or other direction of, or stipulation with, any Governmental Entity.

SECTION 3.11 Employee Benefit Plans; Employment Agreements.

(a) Section 3.11(a) of the Company Disclosure Schedule sets forth a true and complete list of all “employee benefit plans” within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and any other bonus, profit sharing, compensation, pension, severance, deferred compensation, fringe benefit, insurance, welfare, post-retirement, health, life, stock option, stock purchase, restricted stock, tuition refund, service award, company car, scholarship, relocation, disability, accident, sick, vacation, holiday, termination, unemployment, individual employment, consulting, executive compensation, incentive, commission, payroll practices, retention, change in control, non-competition and other plans, agreements, policies, trust funds or arrangements (whether written or unwritten, insured or self-insured, domestic or foreign) (1) established, maintained, sponsored or contributed to (or with respect to which there is any obligation to contribute) by the Company or any entity that would be deemed a “single employer” with the Company under Section 414(b), (c), (m) or (o) of the Code or Section 4001 of ERISA (an “ERISA Affiliate”) or on behalf of any employee, officer, director, consultant or stockholder of the Company (whether current, former or retired) or their beneficiaries or (2) with respect to which the Company or any ERISA Affiliate has or has had any obligation on behalf of any such employee, officer, director, consultant, stockholder or beneficiary (each a “Company Plan” and, collectively, the “Company Plans”).

(b) With respect to each Company Plan, the Company has delivered to Radware true, accurate and complete copies of each of the following: (i) the plan document together with all amendments thereto or a written summary of all material plan terms in the case of an unwritten plan, (ii) to the extent applicable, any trust agreements, custodial agreements, insurance policies, administrative agreements and similar agreements, and investment management or investment advisory agreements, (iii) the summary plan description, employee handbooks and similar employee communications, (iv) to the extent applicable, the most recent determination letter from the IRS and any related correspondence, and any pending request for such determination, (v) to the extent applicable, the three most recently filed Forms 5500, with schedules attached.

(c) No Company Plan (i) is subject to, and no circumstances exist under which the Company could have any material liability under, Section 412 of the Code, Section 302 of ERISA or Title IV of ERISA; (ii) that is a welfare plan is funded through a “welfare benefit fund” within the meaning of Section 419 of the Code; (iii) provides or promises welfare benefits after the termination of employment or other service, except as required by applicable Law; (iv) is funded through a trust intended to meet the requirements of Section 501(c)(9) of the Code; (v) is subject to the laws of a jurisdiction outside of the United States; or (vi) is a nonqualified employee pension benefit plan, deferred compensation plan or excess benefit plan.

(d) (i) Each Company Plan intended to qualify under Section 401(a) of the Code is so qualified and has either received a favorable determination letter from the United States Internal Revenue Service (the “IRS”) or is in a prototype or voluntarily submitted plan form that has been pre-approved by the IRS and that covers all tax law changes prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 and nothing has occurred or, to the knowledge of the Company, is expected to occur through the date of the Effective Time that could cause the loss of such qualification or the imposition of any material penalty or material tax liability; (ii) all payments required to be made with respect to a Company Plan, whether under the terms of such plan, a collective bargaining agreement, insurance policy, other agreement, or by law, have been made on or before the applicable due date or have been provided for by the Company in accordance with the provisions of such Company Plan, applicable Law and GAAP; (iii) no claim, lawsuit, arbitration or other action has been asserted, instituted or, to the knowledge of the Company, is threatened or anticipated against any Company Plan (other than routine claims for benefits and appeals of such claims), any trustee or fiduciaries thereof, the Company, any ERISA Affiliate, any director, officer or employee thereof, or any of the assets of any trust of any Company Plan; (iv) each Company Plan complies in all material respects with and has been maintained and operated, in all material respects, in accordance with its terms and applicable Law, including, without limitation, ERISA and the Code; (v) no non-exempt “prohibited transaction,” within the meaning of Section 4975 of the Code and Section 406 of ERISA, has occurred with respect to a Company Plan; (vi) no Company Plan is under, and the Company has not received any notice of, an audit or investigation by the IRS, U.S. Department of Labor or any other Governmental Entity and no such completed audit, if any, has resulted in the imposition of any tax or penalty; and (vii) with respect to each Company Plan that is funded wholly or partially through an insurance policy, neither the Company nor any ERISA Affiliate has any material liability in the nature of retroactive rate adjustment, loss sharing arrangement or other actual or contingent liability arising wholly or partially out of events occurring on or before the date of this Agreement or is reasonably expected to have such liability with respect to periods through the Effective Time.

(e) Neither the Company, nor any director, officer or employee of the Company (including any ERISA Affiliate thereof) has made any promise or commitment, whether or not legally binding, to create any new Company Plan, or to modify or amend any existing Company Plan. No event, condition or circumstance exists (or will exist following and as a result of the consummation of the transactions contemplated hereby) that (i) would reasonably be expected to result in a material increase of the benefits provided under any Company Plan or the expense of maintaining any Company Plan from the level of benefits or expense incurred for the most recent fiscal year ended before the Effective Time or (ii) would limit the right of the Company to amend, merge or terminate any Company Plan or its related trust.

(f) The Company does not have, and no circumstances exist under which the Company would reasonably be expected to have, any liability for the misclassification of employees as independent contractors, leased employees or otherwise, or vice versa.

(g) Except as set forth on Section 3.12(g) of the Company Disclosure Schedule, the consummation of the transactions contemplated by this Agreement, either alone or in combination with any other event, will not give rise to any liability under any Company Plan, including, without limitation, liability for severance or termination pay, unemployment compensation or withdrawal liability, or accelerate the time of payment or vesting or increase the amount of compensation or benefits due to any employee, director or stockholder of the Company (whether current, former or retired) or their beneficiaries, except that vesting of certain of the Existing Options may be accelerated.

SECTION 3.12 Employees; Labor Matters.

(a) No employee or former employee of the Company is owed any wages, benefits or other compensation for past services (other than wages, benefits and compensation accrued in the ordinary course of business during the current pay period and accrued vacation).

(b) There are no labor disputes, including, without limitation, charges of unfair labor practices within the meaning of the National Labor Relations Act, pending or, to the knowledge of the Company, threatened against the Company. The Company has and is not knowingly engaged in any unfair labor practices within the meaning of the National Labor Relations Act. The Company is not presently a party to, bound by, or in the process of negotiating any collective bargaining agreement or union contract. No organizing activities are presently being made or, to the knowledge of the Company, are anticipated by or on behalf of any labor union with respect to any employees of the Company. There are no strikes, slowdowns, work stoppages, picketing or lockouts pending or, to the knowledge of the Company, threatened, by or with respect to any employees of the Company, and there have been no such strikes, slowdowns, work stoppages, picketing or lockouts within the past two (2) years. The Company is in material compliance with all applicable Laws relating to employment and employment practices, workers' compensation, terms and conditions of employment, worker safety, wages and hours and the Worker Adjustment and Retraining Notification Act. There has been no harassment, discrimination, retaliatory act or similar claim against any officer, director or employee of the Company at any time during the past two (2) years.

SECTION 3.13 Restrictions on Business Activities. Other than this Agreement, there is no non-competition or similar agreement, commitment, judgment, injunction, order or decree binding upon the Company which has the effect of prohibiting or impairing any business operations of the Company as currently conducted. The Company has not entered into any agreement under which it is restricted from selling, licensing or otherwise distributing any of its technology or products, or providing services to, customers or potential customers, in any geographic area, during any period of time or any segment of the market or line of business.

SECTION 3.14 Taxes. Except as set forth in Section 3.14 of the Company Disclosure Schedule:

(a) All Tax Returns required to be filed on or before the date hereof by, or with respect to, the Company have been filed when due. All such Tax Returns were prepared in compliance with all applicable laws and regulations and accurately reflect in all material respects the Taxes due with respect to such Tax Returns. All Taxes (whether or not shown on any Tax Return) owed by, or with respect to, the Company on or before the date hereof, have been timely paid, except those, if any, which are presently being contested in good faith (which are set forth on Section 3.14 of the Company Disclosure Schedule) and for which exist adequate Tax Reserves. The Company has provided to Radware, for the last three (3) taxable years, copies of all income or franchise Tax Returns, including amendments thereto, of the Company. The Company also has provided to Radware copies of all examination reports and statements of deficiencies assessed with respect to the Company for the last three (3) taxable years.

(b) No Tax Proceeding is currently being conducted with respect to the Company, no issues that had been raised in writing by a Tax Authority are pending, no information related to Tax matters has been requested of the Company by any Tax Authority that the Company has failed to provide and the Company has not received notification from any Tax Authority that it intends to commence a Tax Proceeding with respect to the Company. All deficiencies asserted or assessments made as a result of any Tax Proceeding have been paid in full. Any adjustment of Taxes of the Company made by the Internal Revenue Service in any Tax Proceeding, which adjustment is required to be reported to the appropriate state, local or foreign Tax Authority, has been so reported.

(c) There are no agreements for the extension or waiver of the time for assessment of any Taxes relating to the Company. There are no liens other than liens for Taxes not yet due and payable.

(d) No claim has been made in writing by any Tax Authority in a jurisdiction where the Company does not file Tax Returns that the Company is or may be subject to taxation by that jurisdiction.

(e) The Company is not a party to any joint venture, partnership, or other arrangement or contract which is treated as a partnership for federal income tax purposes.

(f) The Company is not a party to any arrangement that would result in the payment of any “excess parachute payment”, as defined in Section 280G of the Code (determined without regard to subsection (b)(4)(B) thereof).

(g) The Company is not a party to, is not bound by, and does not have any obligation under any Tax sharing or Tax indemnification agreement, provision or arrangement, whether formal or informal. No power of attorney, which is currently in effect, has been granted with respect to any matter relating to Taxes of the Company.

(h) The Company is not required to include any adjustment in taxable income under Section 481 of the Code (or any similar provision of the Tax laws of any jurisdiction) as a result of any change in method of accounting or otherwise. No application is pending with respect to the Company with any Tax Authority requesting permission for any change in accounting method.

(i) All Taxes the Company is or was obligated to withhold from amounts owing or paid to any past or present employee, shareholder, creditor or other party have been withheld and remitted to the appropriate Tax Authority within the time required by law.

(j) The amount of Taxes (excluding any provision for deferred Taxes) reflected as a liability on the Unaudited Balance Sheet is a full and adequate reflection of the amount of accrued and unpaid Taxes with respect to the Company for all periods through the date of the Unaudited Balance Sheet for which Tax Returns have not been filed and, since the date of the Unaudited Balance Sheet, the Company has not incurred or accrued any liability for Taxes of any nature (matured, unmatured, fixed or contingent) except for those Taxes incurred or accrued in the ordinary course of business of the Company.

(k) There are no Tax rulings specifying the Company, requests for rulings or closing agreements relating to the Company which could affect the Company’s liability for Taxes after the Closing Date.

(l) The Company does not own any interest in real property in any jurisdiction in which a Tax is imposed on the transfer of a controlling interest in an entity that owns any interest in real property.

(m) Section 3.14(m) of the Company Disclosure Schedule sets forth a list of all jurisdictions to which any Tax is properly payable by, or with respect to, the Company.

(n) The Company does not have any corporate acquisition indebtedness as described in Section 279 of the Code.

(o) The Company has not engaged in any “reportable transaction,” as such term is defined in Treasury Regulations Section 1.6011-4 (b).

SECTION 3.15 Environmental Matters. Except as set forth in Section 3.15 of the Company Disclosure Schedule and except as would not, individually or in the aggregate, have a Company Material Adverse Effect:

(a) The operations of the Company have been and are currently being conducted in compliance in all material respects with all applicable Environmental Laws, and the Company is not aware of the existence of any condition or event that would give rise to material liability on the part of the Company under applicable Environmental Laws.

(b) The Company has not contractually, by operation of law or otherwise, assumed or succeeded to any material Environmental Liabilities of any predecessors or any other person or entity.

(c) The Company has not received any written notice from any Governmental Entity or third party asserting any liability under or violation of any Environmental Laws that remains outstanding or unresolved.

SECTION 3.16 Brokers. Other than the amount set forth on Annex A as part of the Transaction Expenses, no broker, finder or investment banker is entitled to any brokerage, finder’s or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Company.

SECTION 3.17 Intellectual Property.

(a) “Intellectual Property” means all intellectual property owned, used or licensed (as licensor or licensee) by the Company, including:

(i) all domestic and foreign copyright interests in any original work of authorship, whether registered or unregistered, including but not limited to all copyright registrations or foreign equivalent, all applications for registration or foreign equivalent, all moral rights, and all rights to register and obtain renewals and extensions of copyright registrations, together with all other copyright interests accruing by reason of international copyright convention (“Copyrights”);

(ii) all domestic and foreign patents (including certificates of invention and other patent equivalents), provisional applications, patent applications and patents issuing therefrom as well as any division, continuation or continuation in part, reissue, extension, reexamination, certification, revival or renewal of any patent (“Patents”);

(iii) all domestic and foreign trademarks, trade dress, service marks, trade names, icons, logos, slogans, and any other indicia of source or sponsorship of goods and services, designs and logotypes related to the above, in any and all forms, all trademark registrations and applications for registration related to such trademarks (including, but not limited to intent to use applications), and all goodwill related to the foregoing (“Trademarks”);

(iv) all domain name registrations (“Domain Names”);

(v) any formula, design, device, database or compilation, or other information which is used or held for use by a business, which gives the holder thereof an advantage over competitors which do not have or use the same, and which is not generally known by the public. Trade Secrets can include, by way of example, formulas, algorithms, market surveys, market research studies, information contained on drawings and other documents, and information relating to research, development or testing (“Trade Secrets”);

(vi) novel devices, processes, compositions of matter, methods, techniques, know how, discoveries and apparatuses or machines, whether or not patentable (“Inventions”);

(vii) (A) any and all computer programs and/or software programs (including all source code, object code, firmware, programming tools and/or documentation), (B) machine readable databases and compilations, including any and all data and collections of data, and (C) all content contained on Internet site(s) (“Software”);

(viii) all documentation and media constituting, describing or relating to the above, including memoranda, manuals, technical specifications and other records wherever created throughout the world; and

(ix) the right to sue for past, present, or future infringement and to collect and retain all damages and profits related to the foregoing.

(b) Section 3.17(b) of the Company Disclosure Schedule lists (i) all issued Patents, and all pending applications for Patents, owned by the Company; (ii) all registered Trademarks, and all pending applications for Trademarks, owned by the Company; (iii) all registered Copyrights, and all pending applications for Copyrights, owned by the Company; and (iv) all Domain Names owned by the Company.

(c) Section 3.17(c) of the Company Disclosure Schedule lists all licenses, sublicenses, agreements or instruments involving the Intellectual Property of the Company including (i) licenses by the Company to any person of any Intellectual Property; and (ii) all licenses by any other person to the Company of any Intellectual Property (except with respect to generally available “off-the-shelf” software) (each a “License”). Except as set forth in Section 3.17(c) of the Company Disclosure Schedule (i) with respect to each License, there is no material default (or event that with the giving of notice or passage of time would constitute a material default) by the Company, or to the knowledge of the Company, the other party thereto, (ii) there are no pending or, to the knowledge of the Company, threatened claims with respect to any License and (iii) each License is valid, subsisting, in full force and effect and binding upon the Company and, to the knowledge of the Company, the other parties thereto, in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors’ rights generally and general equitable principles regardless of whether such enforceability is considered in a proceeding at law or in equity.

(d) Except as set forth in Section 3.17(d) of the Company Disclosure Schedule, the Company has good and valid title to, or otherwise possesses the rights to use, all Intellectual Property necessary to permit the Company to conduct the business and operations of the Company from and after the Closing Date, in the same manner as it is being conducted as of the date hereof, and to the knowledge of the Company, as currently contemplated to be conducted by the Company. Except as set forth in Section 3.17(d) of the Company Disclosure Schedule, neither the consummation of the transactions contemplated by this Agreement nor the Company's performance hereunder will result in the termination or forfeiture of the Company's rights in such Intellectual Property or the Licenses. All officers, employees and contractors of the Company who have created Intellectual Property that is owned by the Company, have executed an agreement under which all rights, title and ownership in and to such Intellectual Property have been assigned to the Company.

(e) Except as disclosed in Section 3.17(e) of the Company Disclosure Schedule, to the knowledge of the Company, the Company has not infringed upon, misappropriated or misused any intellectual property rights of another person or entity. Except as set forth in Section 3.17(e) of the Company Disclosure Schedule, the Company has not received notice of any alleged infringement, misappropriation or misuse by the Company of the intellectual property rights of another person or entity. Except as disclosed in Section 3.17(e) of the Company Disclosure Schedule, there are no pending, and to the knowledge of the Company, threatened claims or proceedings contesting or challenging the Company's Intellectual Property, or the Company's use of the Intellectual Property owned by another person or entity. To the knowledge of the Company, no third party, including any current or former employee or contractor of the Company, is infringing upon, misappropriating, or otherwise violating the Company's rights to the Intellectual Property owned by the Company.

(f) Patents. Except as set forth on Section 3.17(f) of the Company Disclosure Schedule:

(i) All of the issued Patents and pending applications for Patents of the Company are currently in compliance in all material respects with all legal requirements (including payment of filing, examination, and maintenance fees).

(ii) No Patent of the Company has been or is now involved in any infringement, interference, reissue or reexamination proceeding and, to the knowledge of the Company, no such action is threatened with respect to any of the Patents of the Company.

(g) Trademarks.

(i) All registered Trademarks, and pending applications for Trademarks with the United States Patent and Trademark Office ("PTO") or any other country's trademark office, of the Company are currently in compliance in all material respects with all legal requirements (including the filing of affidavits of use and renewal applications as applicable).

(ii) No Trademark of the Company has been or is now involved in any opposition, infringement, dilution, unfair competition or cancellation proceeding and, to the knowledge of the Company, no such action is threatened with respect to any of the Trademarks of the Company.

(h) Copyrights.

(i) All registered Copyrights and pending applications for Copyrights of the Company are currently in compliance in all material respects with all legal requirements.

(ii) No Copyright of the Company has been or is now the subject of any invalidation or infringement Proceeding and, to the knowledge of the Company, no such action is threatened with respect to any Copyright of the Company.

(i) Domain Names.

(i) All registered Domain Names of the Company are currently in compliance in all material respects with all legal requirements.

(ii) No Domain Name of the Company has been or is now the subject of any dispute resolution or infringement Proceeding and, to the knowledge of the Company, no such action is threatened with respect to any Domain Name of the Company.

(j) Section 3.17(j) of the Company Disclosure Schedule lists all products distributed or sold by the Company.

(k) The Company has taken commercially reasonable steps to protect the proprietary nature of the Intellectual Property owned by the Company and to maintain in confidence all Trade Secrets owned or used by the Company. To the knowledge of the Company, no Trade Secret of the Company has been disclosed or authorized to be disclosed to any person, including any employee, agent, contractor, or other entity, other than pursuant to a non-disclosure agreement or other conditional obligation that protects the Company’s proprietary interests in and to such Trade Secrets.

(l) Section 3.17(l) of the Company Disclosure Schedule contains a true and complete list of all of the (i) Software owned by the Company that is included, embedded or incorporated in or developed for inclusion in the Company’s products or websites, or used in the delivery of the Company’s services (the “Company Software”) and (ii) third-party Software that is licensed to the Company and is included, embedded or incorporated in or developed for inclusion in the Company’s products or websites, or used in the delivery of the Company’s services (except with respect to generally available “off-the-shelf” software) (the “Third-Party Software”). The Company owns full and unencumbered right and good, valid and marketable title to the Company Software and has valid licenses to use the Third-Party Software, and the Company Software is owned by the Company free and clear of any and all Encumbrances. Except as identified in Section 3.17(l) of the Company Disclosure Schedule, no open source or public library software, including any version of any software licensed pursuant to any GNU public license, is, in whole or in part, embodied or incorporated in the Company Software Programs.

(m) The Company employs commercially reasonable measures to ensure that the Company Software contain no “viruses.” For the purposes of this Agreement, “virus” means any computer code intentionally designed to wrongfully disrupt, disable or harm in any manner the operation of any software or hardware.

(n) The Intellectual Property owned by the Company (and, to the knowledge of the Company, the Intellectual Property of third parties licensed to the Company), is free and clear of any and all Encumbrances.

(o) Section 3.17(o) of the Company Disclosure Schedule sets forth all agreements by which the Company is obligated to make to third parties any payments related to Intellectual Property.

(p) Other than as set forth in Section 3.17(p) of the Company Disclosure Schedule, to the knowledge of Company, there has been no breach of security involving any the Company websites or information assets. All data which has been collected, stored, maintained or otherwise used by the Company has been, to the knowledge of the Company, collected, stored, maintained and used in accordance with all applicable U.S. and foreign laws, rules, regulations, guidelines and industry standards. The Company has not received a notice of noncompliance with applicable data protection laws, rules, regulations, guidelines or industry standards.

SECTION 3.18 Material Contracts. Section 3.18 of the Company Disclosure Schedule contains a list of each of the following contracts (or, in the case of oral contracts, summaries thereof) to which the Company is a party or by which the Company, or any of the Company’s assets or properties, is bound or subject (collectively, the “Material Contracts”):

(a) any agreement or series of related agreements requiring aggregate payments by or to the Company of more than Fifty Thousand Dollars (\$50,000) per year;

(b) any agreement with or for the benefit of any current or former officer or director, holder of any security, employee or consultant of the Company under which the Company has any obligations as of the date hereof and that (i) involves the making of payments exceeding Fifty Thousand Dollars (\$50,000) in any year, other than regular salary and bonus amounts, (ii) contains non-competition provisions imposing restrictions on the Company or a senior executive officer or key employee of the Company (other than those in favor of the Company), or (iii) involves any severance or termination payments or other similar obligation;

(c) any agreement with any labor union or association representing any employee of the Company;

(d) any agreement for the sale of any of the assets, properties or securities of the Company other than in the ordinary course of business or for the grant to any person of any option, right of first refusal or preferential or similar right to purchase any such assets, properties or securities (other than the Rights Agreements);

(e) any agreement of surety, guarantee or indemnification, other than agreements in the ordinary course of business with respect to obligations in an aggregate amount not in excess of Fifty Thousand Dollars (\$50,000), other than the security agreement relating to the Notes;

(f) any agreement, note or other document relating to or evidencing outstanding indebtedness of the Company for borrowed money (including capitalized lease obligations) in excess of Fifty Thousand Dollars (\$50,000), other than the Notes;

(g) any phantom stock plan or bonus, incentive or similar agreement, arrangement or understanding, other than the Key Contributor Plan and the Investor Incentive Agreement;

(h) any agreement involving the assignment, transfer, license (whether as licensee or licensor), pledge or Encumbrance of any Intellectual Property owned or used by the Company, except for any generally available “off-the-shelf” Software, other than the security agreement relating to the Notes;

(i) any distribution or sales representative agreement or agreement appointing any agent; and

(j) any other agreement that is material to the business, operations or financial condition of the Company.

True and complete copies of all Material Contracts (and all amendments, waivers or other modifications thereto) have been furnished or made available to Radware. Each Material Contract is valid, subsisting, in full force and effect and binding upon the Company and, to the knowledge of the Company, the other parties thereto in accordance with its terms. The Company is not in default (and, to the knowledge of the Company, no condition exists that, with notice or lapse of time or both, would constitute a default by the Company) under any Material Contract, which default would give the other party the right to terminate or modify such Material Contract or would accelerate any obligation or payment by the Company, nor, to the knowledge of the Company, is any other party to any Material Contract in default thereunder (or, does any condition exist that, with notice or lapse of time or both, would constitute a default by any such party). None of the Material Contracts is currently being renegotiated. The validity, continuation and effectiveness of each of the Material Contracts will not be materially adversely affected solely as a result of the transactions contemplated by this Agreement. To the knowledge of the Company, no party to any of the Material Contracts has made, asserted or has any defense, setoff or counterclaim under its Material Contract or has exercised any option granted to it to cancel, terminate or shorten the term of its Material Contract. Notwithstanding anything in this Agreement to the contrary, each party acknowledges and agrees that the consent set forth on Schedule 3.05(a) will not be obtained, and that the Company is not making any representation in relation to the requirement of such consent.

SECTION 3.19 Title to Properties; Absence of Encumbrances. The Company has good and valid title to or, in the case of leases and licenses, valid and subsisting leasehold interests or licenses in, all of its properties and assets of whatever kind (whether real or personal, tangible or intangible) used or held for use in its business, including, without limitation, all properties and assets that are shown on the Unaudited Balance Sheet (except for assets sold in the ordinary course of business since the date of such Unaudited Balance Sheet), which represent all such property and assets that are used in the conduct of its businesses as presently conducted, in each case free and clear of any and all Encumbrances, except (i) for those securing Taxes, assessments and other governmental charges or levies not yet due and payable (excluding any imposed pursuant to any of the provisions of ERISA), (ii) such imperfections in title, liens and easements as do not detract from or interfere with the use of the properties subject thereto or affected thereby or otherwise impair business operations involving such properties, and (iii) Encumbrances securing any debt which is reflected in the Financial Statements (encumbrances in clauses (i) - (iii) being “Permitted Encumbrances”).

SECTION 3.20 Real Property. Section 3.20 of the Company Disclosure Schedule contains a complete and correct list of all real property (including buildings and structures) leased or subleased by the Company and all interests therein (including a street address). The Company does not own and has never owned any real property. No condemnation or other proceeding is pending or, to the knowledge of the Company, threatened which would affect the use of any such property by the Company. The Company enjoys peaceful and undisturbed possession under all real property leases under which it is operating in accordance with the terms of such leases, and all rents and additional rents due to date from the Company under such leases have been paid in full.

SECTION 3.21 Transactions with Affiliates; Management Relationships.

(a) The Company has not, directly or indirectly, engaged in any continuing transactions or financial or commercial arrangements (i) with any stockholder of the Company, other than as a board member or pursuant to the Company’s financing activities or (ii) (except for employment arrangements with its employees) with any officer or director or, to the knowledge of the Company, with any of their respective affiliates or relatives (each a “Related Party”). Except for (i) employment arrangements with its employees, (ii) the Company Certificate of Incorporation, (iii) the Company By-Laws, (iv) applicable Law, (v) the agreements evidencing Existing Options and (vi) the Key Contributor Plan and the Investor Incentive Agreement, the Company does not have any obligation to or claim against any Related Party, and no Related Party has any obligation to or claim against the Company.

(b) No executive officer or director of the Company owns any interest in any property or assets of the Company (except as a stockholder of the Company) and, to the knowledge of the Company, no executive officer of the Company owns any interest in (i) any current competitor, customer or supplier of the Company or (ii) any person that is currently a party to any material contract or agreement with the Company, other than holdings of less than 1% of a class of a company’s publicly traded securities.

SECTION 3.22 Insurance. Section 3.22 of the Company Disclosure Schedule lists all insurance policies owned or held by the Company on the date hereof. The insurance coverage afforded by such policies is customary and adequate for companies in similar lines of business, similarly situated. All such policies are in full force and effect, all premiums with respect thereto have been paid to the extent due, no notice of cancellation or termination has been received with respect to any such policy and no claim is currently pending under any such policy involving an amount in excess of Twenty Thousand Dollars (\$20,000).

SECTION 3.23 Books and Records.

(a) The books and records of the Company are complete and correct in all material respects and have been maintained in accordance with sound business practices.

(b) The minute books of the Company, which have been previously provided to Radware, contain complete and accurate records of all meetings and accurately reflect all other corporate action of the stockholders and board of directors of the Company through the date of this Agreement.

SECTION 3.24 Intentionally Omitted.

SECTION 3.25 Employee Conflicts. To the knowledge of the Company, no employee of the Company is in violation of any term of any employment contract, inventions disclosure agreement, confidentiality agreement, non-competition agreement or restrictive covenant to or with a former employer relating to the right of any such employee to be employed by the Company because of the nature of the business conducted or presently proposed to be conducted by the Company or relating to the use of trade secrets or proprietary information of others.

SECTION 3.26 Certain Business Practices. The Company has not (i) used any funds for unlawful contributions, gifts, entertainment or other unlawful payments related to a political activity, (ii) made any unlawful payment to any foreign or domestic government official or employee or to any foreign or domestic political party or campaign or violated any provision of the Foreign Corrupt Practices Act of 1977, as amended or (iii) made any other unlawful payment.

SECTION 3.27 Bank Accounts. Section 3.27 of the Company Disclosure Schedule sets forth a complete and correct list of each bank in which the Company has an account or safe deposit or lockbox, the account or box number, as the case may be, and the name of every person authorized to draw thereon or having access thereto.

SECTION 3.28 No Required Disclosure. The Company is not required to disclose the existence of this Agreement, the terms hereof, or the transactions contemplated hereby, to any person (other than to its directors, officers, employees, any Company Recipient or any holder of Existing Options).

SECTION 3.29 Internal Controls. The Company maintains a system of internal accounting controls sufficient to provide reasonable assurance that (i) transactions are executed in accordance with management's general or specific authorizations, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain asset accountability, (iii) access to assets is permitted only in accordance with management's general or specific authorization, and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

SECTION 3.30 Key Contributor Plan and Investor Incentive Agreement.

(a) Key Contributor Plan. On the Closing Date, pursuant to the Key Contributor Plan, the amounts set forth opposite each Key Contributor Plan Participant's name on Annex A hereto are the amounts owing and payable to the Key Contributor Plan Participants and no other amounts are owed to any other parties pursuant to the Key Contributor Plan as a result of the transactions contemplated hereby other than as described in Sections 2.07(a)(ii) and 2.08(b), if applicable.

(b) Investor Incentive Agreement. On the Closing Date, pursuant to the Investor Incentive Agreement, the amounts set forth opposite each Investor Incentive Agreement Recipient's name on Annex A hereto are the amounts owing and payable to the Investor Incentive Agreement Recipients and no other amounts are owed to any other parties pursuant to the Investor Incentive Agreement as a result of the transactions contemplated hereby, other than as described in Section 2.07(b)(ii) and 2.08(b), if applicable.

SECTION 3.31 Disclosure. No representation or warranty by the Company herein, the Company Disclosure Schedule, nor any certificate or exhibit furnished pursuant to this Agreement or in connection with the transactions contemplated herein, contains any untrue statement of a material fact, or omits a material fact necessary to make the statements contained herein or therein, in light of the circumstances in which they were made, not misleading.

ARTICLE IV
REPRESENTATIONS AND WARRANTIES OF THE COMPANY RECIPIENTS

Each Company Recipient hereby represents and warrants to Radware, Parent and Merger Sub on the date hereof, with respect only to himself, herself or itself and the Company securities held by him, her or it, as follows (and the Company hereby represents and warrants to Radware, Parent and Merger Sub on the date hereof with respect to Section 4.02 as it relates to the Company Stockholders set forth on Schedule 4.02):

SECTION 4.01 Title to Notes and Shares. Each Company Stockholder and Company Noteholder represents that he, she or it owns the Notes and/or number of shares of Company Capital Stock set forth opposite his, her or its name on Section 3.03(b) of the Company Disclosure Schedule, free and clear of any and all Encumbrances other than the Registration Rights Agreement dated March 24, 2004, as amended (the "Registration Rights Agreement") and the Investors Rights Agreement dated March 24, 2004, as amended (the "Investors Rights Agreement") and with the Registration Rights Agreement the "Rights Agreements"). Upon consummation of the Closing, in accordance with the terms set forth in this Agreement, Radware shall acquire good, valid and marketable title to the Notes and Company Capital Stock being sold by each Company Noteholder and Company Stockholder hereunder, as the case may be, free and clear of any liens or restrictions on transfer and free and clear of any Encumbrances, other than the Rights Agreements.

SECTION 4.02 Authority Relative to this Agreement; Action. Each Company Stockholder and Company Noteholder has all necessary power and authority to execute and deliver this Agreement and each of the Ancillary Agreements to which it is a party and to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by each Company Stockholder and Company Noteholder and the consummation by each Company Stockholder and Company Noteholder of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary action on the part of each Company Stockholder and Company Noteholder. This Agreement, Ancillary Agreements to which each Company Stockholder and Company Noteholder is a party have been duly and validly executed and delivered by each Company Stockholder and Company Noteholder and, assuming the due authorization, execution and delivery of this Agreement and the Ancillary Agreements by each of the other parties hereto and thereto, constitutes, or, in the case of the Ancillary Agreements to which it is a party have been or, if executed after the date hereof and at or prior to the Effective Time, will constitute, legal, valid and binding obligations of each Company Stockholder and Company Noteholder, enforceable against each Company Stockholder and Company Noteholder in accordance with their respective terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles regardless of whether such enforceability is considered in a proceeding at law or in equity.

SECTION 4.03 No Conflict; Required Filings and Consents. (a) Each Company Recipient acknowledges that: The execution and delivery of this Agreement and the Ancillary Agreements to which such Company Recipient is a party by such Company Recipient and the consummation by such Company Recipient of the transactions contemplated hereby and thereby will not (i) conflict with or violate any Law applicable to such Company Recipient or by which any of its respective properties or operations are bound or affected or (ii) conflict with, result in any material breach of, or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation of, or result in the creation of an Encumbrance on any of the properties or assets of the Company pursuant to, any material note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which it is a party or by which its properties, is bound.

(b) The execution and delivery of this Agreement and the Ancillary Agreements to which such Company Stockholder is a party by such Company Stockholder do not, and the performance of this Agreement and such Ancillary Agreements and the consummation of the transaction contemplated hereby and thereby, will not, require such Company Stockholder to obtain any waiver, consent, approval, authorization or permit of, or make any filing with or notification to, any Governmental Entity or other third party, except the filing of the Certificate of Merger as required by the Delaware Law.

SECTION 4.04 Legal Proceedings. There is no pending Proceeding against such Company Recipient that challenges, or may have the effect of preventing, delaying or making illegal, or otherwise interfering with, the Merger or any of the other transactions contemplated hereby and, to the knowledge of such Company Recipient, no such Proceeding has been threatened. To the knowledge of such Company Recipient, no event or circumstance exists that would give rise to or serve as a basis for the commencement of any such Proceeding.

SECTION 4.05 Brokers. Other than the amount set forth on Annex A as part of the Transaction Expenses, no broker, finder or investment banker is entitled to any brokerage, finder's fee or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of any Company Recipient.

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF RADWARE, MERGER SUB AND PARENT

Radware, Merger Sub and Parent represent and warrant to the Company as of the date hereof that the statements contained in this Article V are true and correct, except as set forth in the disclosure schedule delivered by Radware to the Company on the date hereof (the “Radware Disclosure Schedule”). The Radware Disclosure Schedule shall be arranged in paragraphs corresponding to the numbered and lettered paragraphs in this Article V and the disclosure in any paragraph shall qualify other paragraphs in this Article V only to the extent that it is specifically indicated in such paragraph.

SECTION 5.01 Organization and Qualification. Each of Radware, Parent and Merger Sub is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization and each of Radware, Parent and Merger Sub has the requisite corporate power and authority necessary to own, lease and operate the properties it owns, leases or operates and to carry on its business as it is now being conducted.

SECTION 5.02 Authority Relative to this Agreement. Each of Radware, Parent and Merger Sub has all necessary corporate power and authority to execute and deliver this Agreement and each of the Ancillary Agreements to which it is a party and to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by Radware, Parent and Merger Sub and the consummation by Radware, Parent and Merger Sub of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary corporate action on the part of Radware, Parent and Merger Sub, as the case may be, and no other corporate or stockholder proceedings on the part of Radware, Parent or Merger Sub are necessary to authorize this Agreement or any of the Ancillary Agreements to which it is a party or to consummate the transactions so contemplated. This Agreement has been, and the Ancillary Agreements to which it is a party have been or, if executed after the date hereof, will be, duly and validly executed and delivered by Radware, Parent and Merger Sub and, assuming the due authorization, execution and delivery of this Agreement and the Ancillary Agreements by each of the other parties hereto and thereto, constitutes, or, in the case of the Ancillary Agreements have been or, if executed after the date hereof and prior to the Effective Time, will constitute, legal, valid and binding obligations of Radware, Parent and Merger Sub, enforceable against Radware, Parent and Merger Sub in accordance with their respective terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors’ rights generally and general equitable principles regardless of whether such enforceability is considered in a proceeding at law or in equity.

SECTION 5.03 No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement and the Ancillary Agreements to which it is a party by Radware, Parent and Merger Sub do not, and the performance of this Agreement and the Ancillary Agreements by Radware, Parent and Merger Sub and the consummation by Radware, Parent and Merger Sub of the transactions contemplated hereby and thereby will not, (i) conflict with or violate the organizational documents of Radware, Parent or Merger Sub, (ii) conflict with or violate any Law applicable to Radware, Parent or Merger Sub or by which any of their respective properties is bound or affected or (iii) conflict with, result in any breach of, or constitute a default (or an event that with notice or lapse of time or both would become a default) under, or impair Radware's, Parent's or Merger Sub's rights or alter the rights or obligations of any third party under, or give to others any rights of termination, amendment, acceleration or cancellation of, or result in the creation of an Encumbrance on any of the properties or assets of Radware, Parent or Merger Sub pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which Radware, Parent or Merger Sub is a party or by which Radware, Parent or Merger Sub or any of their respective properties is bound or affected except, in the case of clauses (ii) and (iii), for such conflicts, breaches, violations, defaults, impairments or alterations that would not prevent or delay consummation of the Merger, or otherwise prevent or delay Radware, Parent or Merger Sub from performing its obligations under this Agreement.

(b) The execution and delivery of this Agreement and the Ancillary Agreements by Radware, Parent and Merger Sub, as applicable, do not, and the performance of this Agreement and the Ancillary Agreements by Radware, Parent and Merger Sub, as applicable, and the consummation by Radware, Parent and Merger Sub of the transactions contemplated hereby and thereby, as applicable, will not, require any waiver, consent, approval, authorization or permit of, or filing with or notification to, any Governmental Entity or other third party, except (i) for the filing of the Certificate of Merger as required by the Delaware Law and (ii) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not prevent or delay consummation of the Merger, or otherwise prevent or delay Radware, Parent or Merger Sub from performing its obligations under this Agreement.

SECTION 5.04 Financial Ability. Radware or Parent has sufficient cash available to enable it to pay the Closing Date Purchase Price at the Closing and to satisfy its other obligations hereunder. Since the date of Parent's most recent public filing with the United States Securities and Exchange Commission containing financial statements, there has occurred no event likely to have a material adverse effect on Radware's or Parent's ability to pay the Additional Amount and fulfill its obligations under this Agreement.

SECTION 5.05 Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's fee or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Radware, Parent or Merger Sub.

SECTION 5.06 Restrictions on Business Activities. There is no non-competition or similar agreement, commitment, judgment, injunction, order or decree binding upon Radware or Parent which has the effect of prohibiting or impairing Radware or Parent from carrying out the business operations of the Company as currently conducted, including the marketing and sale of the Inflight and Percept Product Line. Neither Radware nor Parent has entered into any agreement under which it is restricted from selling, licensing or otherwise distributing the Inflight and Percept Product Line, or providing related services to, customers or potential customers, in any geographic area, during any period of time or any segment of the market or line of business.

ARTICLE VI
COVENANTS OF THE COMPANY

SECTION 6.01 Confidentiality. The Company Recipients shall, and the Company Recipients shall cause their directors, officers, employees, agents, consultants and/or representatives to, maintain the Confidential Information in confidence using at least the same degree of care as it employs with respect to its own proprietary and confidential information, but in all events at least a reasonable degree of care. “Confidential Information” shall mean all trade secrets, know-how, customer lists, technical information, proprietary information, technologies, processes and formulae, source code, algorithms, architecture, structure, display screens and development tools, data, plans and drawings and blue prints, whether tangible or intangible and whether or how stored, compiled, or memorialized physically, electronically, photographically, or otherwise, owned, used or licensed by Radware or Parent as licensee or licensor and that have been used or are used in or are material to the conduct of Radware’s or Parent’s business shall constitute Confidential Information.

SECTION 6.02 Public Announcements. The parties agree that any press release or other public statement with respect to this Agreement or the transactions contemplated hereby shall be only as agreed upon in advance by Radware and the Company.

ARTICLE VII
CLOSING DELIVERIES

SECTION 7.01 Closing Deliveries for the Company and the Company Recipients. The obligations of Radware and Merger Sub to effect the Merger are subject to satisfaction of the following conditions, any of which may be waived by Radware in writing:

(a) All directors of the Company whom Radware has requested in writing not less than five (5) days prior to the scheduled Closing Date to resign shall have resigned or otherwise been removed from office.

(b) Company Required Consents listed on Schedule 7.01 (and, in any event, all consents, approvals or clearances from Governmental Entities) shall have been obtained or made in a form and manner reasonably acceptable to Radware.

(c) The Company, the Company Recipients and the Seller Representatives shall have executed and delivered the Escrow Agreement, in substantially the form attached as Exhibit A hereto.

(d) Radware shall have received a certificate signed on behalf of the Company by the Chief Financial Officer of the Company, which shall certify that the allocation of the Net Aggregate Merger Consideration among the Company Noteholders and Company Stockholders set forth thereon is accurate and shall constitute the Net Aggregate Merger Consideration issuable to the Company Noteholders and Company Stockholders in exchange for the Notes and Company Capital Stock, pursuant to this Agreement (including Annex A hereto). The information and the calculations set forth in such certificate shall be binding on the Company Noteholders and Company Stockholders and Radware shall have the right to rely on such information and calculations.

(e) Pay-off letters evidencing either receipt in full of the Transaction Expenses or indicating the amount required to be paid in order to satisfy in full the Transaction Expenses shall have been executed and delivered by each party receiving any portion of the Transaction Expenses.

(f) Radware shall have received a certificate of the Secretary of the Company dated as of the Closing Date in form and substance reasonably satisfactory to Radware attesting to the incumbency of the officers of the Company executing the Agreement or any Ancillary Agreements to which the Company is a party and certifying as to the following: (i) a true and correct copy of the Certificate of Incorporation of the Company in effect as of the Closing, certified by the Secretary of State of the State of Delaware, (ii) a true and correct copy of the By-Laws of the Company in effect as of the Closing, (iii) a true and correct copy of the resolutions of the Company's Board of Directors authorizing the execution, delivery and performance of this Agreement and all agreements and transactions contemplated hereby, including the termination or cancellation of Existing Options, and (iv) this Agreement shall have been duly approved by the requisite vote or consent of the holders of Company Capital Stock in accordance with the Delaware Law.

(g) The Company shall have delivered to Radware a certificate of good standing of the Company from the State of Delaware dated no more than five (5) business days prior to the Closing Date.

(h) The Company shall have delivered to Radware an opinion of Wyrick Robbins Yates & Ponton, LLP, dated the date hereof and addressed to Radware, in substantially the form attached as Exhibit B hereto.

(i) This Agreement shall have been duly approved by the requisite vote or consent of the holders of Company Capital Stock in accordance with the Delaware Law.

(j) The Company shall have delivered a certificate, executed by the Chief Financial Officer of the Company, certifying that, in accordance with the terms of the Company Option Plan, each of the Existing Options that has not been exercised prior to the Effective Time have been cancelled and terminated, and are of no further force or effect from and after the Closing.

(k) Radware shall have received a certificate executed by the Company acknowledging that each of the Key Contributor Plan Participants and the Investor Incentive Agreement Recipients have received any and all proceeds that they are entitled to as of the Closing Date pursuant to the Key Contributor Plan and the Investor Incentive Agreement, respectively.

(l) Radware shall have received a certificate, in the form and manner that complies with all of the requirements of Treasury Regulation Section 1.1445-2(c)(3) that its capital stock is not a U.S. real property interest.

ARTICLE VIII
INDEMNIFICATION

SECTION 8.01 General Indemnification of Radware. Subject to Section 8.04, Radware, Parent, Merger Sub, the Surviving Corporation and their respective officers, directors, stockholders, partners, employees, agents and affiliates and their heirs, successors and assigns (collectively, the “Radware Indemnitees”) shall be indemnified, defended and held harmless by the Company Recipients (severally and not jointly as more fully set forth below) from and against any and all liabilities, obligations, losses, assessments, damages, deficiencies, demands, claims, actions, causes of action, costs and expenses (including, without limitation, interest, penalties, court costs and reasonable attorneys’ fees and expenses and any reasonable amounts paid in investigation, defense or settlement of any of the foregoing) of any kind, manner or nature whatsoever, whether or not arising out of third-party claims or claims by one or more parties hereto against any other party(ies) hereto (collectively, “Losses”), if, as and when incurred by the Radware Indemnitees, based upon, arising out of or otherwise in respect of:

- (a) any misrepresentation or breach of warranty by the Company or any Company Recipient contained herein, in any Ancillary Agreement or in any document or agreement delivered pursuant hereto or thereto or any claim by a third party which would constitute such a misrepresentation or breach provided that for purposes of determining whether there has been such a breach there shall be disregarded any Company Material Adverse Effect standard or any other materiality or similar materiality qualification contained in any representation, warranty or covenant herein or in any Ancillary Agreement;
- (b) any breach of or failure to perform any covenant or agreement by the Company or any Company Recipient or the Sellers Representatives contained herein or in any Ancillary Agreement;
- (c) any claim arising out of any dispute among any Company Recipients, or between any Company Recipient(s) and the Sellers Representatives, or any claims by any holders of Notes or Company Capital Stock regarding the allocation of consideration in the Merger to them;
- (d) Transaction Expenses; and
- (e) any claims for payment under the Key Contributor Agreement or the Investor Incentive Agreement.

With respect to the indemnification obligations set forth in Sections 8.01(a) and (b) above for breaches by the Company Recipients, the liability shall be indemnifiable individually by the breaching Company Recipient, and not by any other Company Recipients based on Pro Rata Interest. All other indemnification obligations of the Company Recipients shall be several and not joint based on each Company Recipient’s Pro Rata Interest.

SECTION 8.02 Radware Indemnification Obligation. Subject to Section 8.04, the Company Recipients and their respective officers, directors, employees, stockholders, partners, members, affiliates and agents and their heirs, successors and assigns (collectively, the “Company Recipient Indemnitees”) shall be indemnified, defended and held harmless by Radware, Parent and Merger Sub, joint and severally, from and against any and all Losses, if, as and when incurred by the Company Recipient Indemnitees based upon, arising out of or otherwise in respect of:

(a) any misrepresentation or breach of warranty by Radware or Parent contained herein, in any Ancillary Agreement or in any document or agreement delivered pursuant hereto or thereto, or any claim by a third party which would constitute such a misrepresentation or breach; and

(b) any breach of or failure to perform any covenant or agreement by Radware or Parent contained herein or in any Ancillary Agreement, or any claim by a third party which would constitute such a breach or failure.

SECTION 8.03 Procedure.

(a) For the purposes of this Section 8.03, the term “Indemnitee” shall refer to the Radware Indemnitee or the Company Recipient Indemnitee, as applicable, indemnified or entitled, or claiming to be entitled, to be indemnified pursuant to the provisions of Sections 8.01 or 8.02 and the term “Indemnitors” shall refer to the Company Recipients, Radware, Parent or Merger Sub, as applicable. All actions to be taken by or on behalf of the Company Recipients shall be taken by both Sellers Representatives, and all notices by the Company Recipients or the Company Recipient Indemnitees shall be given to or by the Sellers Representatives.

(b) Subject to subsection (vi) below, the Indemnitee shall promptly give the Indemnitor notice of any matter which the Indemnitee reasonably believes has given rise to a right of indemnification under this Agreement (a “Claim”), stating the amount of the Losses (whether actual or reasonably estimated), the method of computation thereof and the basis for the Claim and shall specify the provision or provisions of this Agreement under which the Claim is asserted, in each case with reasonable particularity. Failure to give timely notice of a matter that may give rise to a Claim shall not affect the rights of the Indemnitee to collect such Claim from the Indemnitors except to the extent that it materially and adversely prejudices the Indemnitor’s ability to defend such Claim and except to the extent the notice is not given during the time period for which indemnification claims may be asserted under this Agreement. The obligations and liabilities of the Indemnitors under this Article VIII with respect to Losses arising from Claims of any third party against the Indemnitee that are subject to the indemnification provided for in this Article VIII (“Third-Party Claims”) shall be governed by the following additional terms and conditions:

(i) if the Indemnitee shall receive notice of any Third-Party Claim, the Indemnitee shall give the Indemnitor prompt notice of such Third-Party Claim, and shall permit the Indemnitor, at its option, to assume the defense and/or management of such Third-Party Claim at the Indemnitor’s expense and through counsel of its choice if the Indemnitor gives prompt notice of its intention to do so to the Indemnitee (the “Election Notice”) and does so promptly thereafter;

(ii) if the Indemnitor exercises its right to undertake the defense and/or management of any such Third-Party Claim, the Indemnatee shall cooperate with the Indemnitor in such defense and/or management and make available to the Indemnitor (if the Indemnitors are the Company Recipients, the Sellers Representatives) all witnesses, pertinent records, materials and information in the Indemnatee's possession or under its control relating thereto as is reasonably required by the Indemnitor;

(iii) if the Indemnitor does not exercise its right to assume the defense and/or management of any Third-Party Claim as provided above, or the Indemnitor does exercise such right but does not diligently pursue the defense of the Third Party Claim, the Indemnatee may, directly or indirectly, conduct the defense and/or management of any such Third-Party Claim in any manner it reasonably may deem appropriate and at the expense of Indemnitors, for which the Indemnatee (x) if it is a Radware Indemnatee, may seek reimbursement from the Escrow Indemnity Account, and (y) if it is a Company Recipient Indemnatee, may seek reimbursement from the Indemnitor, and the Indemnitor shall cooperate with the Indemnatee in such defense and/or management and make available to the Indemnatee all witnesses, pertinent records, materials and information in the Indemnitor's possession or under its control relating thereto as is reasonably required by the Indemnatee;

(iv) the Indemnitor will not consent to the entry of any judgment or enter into any settlement with respect to a Third-Party Claim without the prior written consent of the Indemnatee (not to be unreasonably withheld or delayed), unless (x) the judgment or proposed settlement does not impose an injunction or other equitable relief upon the Indemnatee and (y) the judgment or proposed settlement includes as an unconditional term thereof the giving by the claimant or plaintiff to the Indemnatee of an unconditional release from all liability in respect of such Third-Party Claim;

(v) if the Indemnatee conducts the defense and/or management of a Third-Party Claim, as provided above, the Indemnatee will not consent to the entry of any judgment or enter into any settlement with respect to a Third-Party Claim without the prior written consent of the Indemnitor, which will not be unreasonably withheld, delayed or conditional; and

(vi) if there is a reasonable probability that a Third-Party Claim may materially and adversely affect the Indemnatee other than as a result of money damages or other monetary payments, the Indemnatee shall have the right, at its own cost and expense, to participate in the defense of the Third-Party Claim.

(c) Characterizations of Indemnification Payment. The Company Recipients and Radware and Parent agree that they shall treat, and they shall cause their respective affiliates to treat, any and all indemnification payments made hereunder as an adjustment to the Net Aggregate Merger Consideration.

SECTION 8.04 Certain Limits on Indemnification.

(a) Indemnification Caps and Other Limitations. The Radware Indemnitees shall, in full and complete satisfaction of any claims for indemnification arising under Section 8.01 above, be entitled to receive from the Escrow Indemnity Account (and delivered by the Escrow Agent) such amount as is equal to the value of the Losses as to which the Radware Indemnitees are entitled to indemnification, as determined pursuant to the terms of this Agreement and the Escrow Agreement; provided, that Radware Indemnitees shall not be entitled to receive indemnification under Sections 8.01(a) or 8.01(b) unless and until the sum of the aggregate amount of Losses under such subsections exceeds One Hundred Thousand Dollars (\$100,000) (the “Basket Amount”), after which Radware Indemnitees shall be entitled to the entire amount of such Losses, including Losses covered by the Basket Amount incurred under such sections. The limitation set forth in this Section 8.04(a) shall not apply with respect to (x) breaches of representations and warranties set forth in Sections 3.03, 3.04, 4.01 and 4.02 hereof. The Radware Indemnitees shall have the right to satisfy any claims for Losses arising pursuant to this Agreement (i) first, by set-off against the Additional Payment, the Additional Key Contributor Plan Amount and the Additional Investor Incentive Agreement Amount, if such payments are unpaid at the time a claim for indemnification is made; (ii) second, from the Escrow Indemnity Account; and (iii) third, from the Company Recipients; provided that in no event shall the liability of any Company Recipient with respect to Losses under this clause (iii) exceed the amount of consideration received by such Company Recipient under this Agreement.

(b) Notwithstanding anything to the contrary contained herein, Radware shall have no obligation to indemnify a Company Recipient Indemnatee with respect to Losses pursuant to Section 8.02 above unless it shall have received written notice of a claim for indemnification signed by both Sellers Representatives.

(c) For purposes of this Article VIII, the amount of any Losses shall be determined net of any insurance proceeds actually received by the applicable Indemnitees in connection with the matter out of which such Losses shall arise.

(d) Subject to the proviso of this Section 8.04(d), no claim under this Article VIII shall be made after the expiration of the survival periods referred to in Section 9.01 hereof, provided, however, that if written notice of a claim is made prior to the expiration of the survival period (such notice setting forth in reasonable detail the basis for such claim), then the relevant representation, warranty or covenant shall survive as to such claim only until the claim has been fully and finally resolved.

(e) The remedies provided in this Article VIII shall be exclusive of any other rights or remedies which might otherwise be available to any indemnified parties upon the occurrence of any event described in this Article VIII or which otherwise arise out of, relate to or with respect to this Agreement or the transactions contemplated hereby other than for fraud. Nothing contained herein, however, shall preclude indemnified parties from seeking injunctive or other equitable relief under circumstances where such relief might be appropriate with the proviso that the moving party shall not be entitled to ancillary relief in the nature of damages or fee awards unless specifically so provided for herein.

SECTION 8.05 Tail Insurance. At the Company's election, (i) the Company shall purchase prior to the Closing, and the Surviving Entity and Radware shall maintain following the Closing, "tail" or "run-off" insurance policies with a claims period of six (6) years from the Closing Date with respect to the current directors' and officers' liability insurance of the Company with substantially the same coverage and in amount and scope no less favorable, in the aggregate, than the existing directors' and officers' liability insurance policy of the Company (the "Current Policy") for claims arising from facts or events that existed or occurred on or prior to the Closing Date or (ii) if the Company shall not have obtained such policies, Radware will provide, or cause the Company to provide, for a period of not less than six (6) years after the Closing Date, the Covered Parties who are insured under the Current Policy with an insurance and indemnification policy that provides coverage for events occurring at or prior to the Closing that is no less favorable, taken as a whole, than the Current Policy or, if substantially equivalent insurance coverage is unavailable, the best available coverage; provided, however, that in no event shall the Surviving Entity be required to expend annually in excess of two hundred and fifty percent (250%) of the annual premium currently paid by the Company under the Current Policy (the "Insurance Amount"); provided, further, however, that if the premium of such insurance coverage exceeds the Insurance Amount, the Company shall be obligated to obtain, and the Surviving Corporation shall be obligated to maintain, a policy with the greatest coverage available for a cost not exceeding the Insurance Amount. Radware shall pay or cause Company to pay for all premiums under the tail or run-off insurance policies and directors' and officers' insurance and indemnification policies contemplated by this Section 8.05 not exceeding the Insurance Amount.

SECTION 8.06 Release. Upon payment of the Closing Date Purchase Price as provided for in this Agreement, the Company Stockholders and Company Noteholders hereby acknowledge that they are not owed any additional amounts and hereby release the Company, Radware, Parent, Merger Sub and the Surviving Corporation and any of their respective directors, officers, employees, agents and advisors from any amount owing to such noteholders or stockholders (i) in their capacity as noteholders and stockholders of the Company, (ii) pursuant to the Company Certificate of Incorporation or Company By-Laws or the Delaware Law, other than indemnification obligations to them in their capacity as officers and directors of the Company which may arise following the Closing Date (even if relating to events occurring prior to the Closing Date), or (iii) pursuant to the Key Contributor Plan or the Investor Incentive Agreement, other than the right to receive the Additional Payment, the Escrow Amount, the Additional Key Contributor Amount and the Additional Investor Incentive Amount in accordance with this Agreement; provided that nothing herein shall release any claims related to this Agreement or the performance by Radware of its obligations hereunder.

ARTICLE IX
GENERAL PROVISIONS

SECTION 9.01 Survival of Representations and Warranties. The representations and warranties made by the Company in this Agreement or any Ancillary Agreements shall survive the Effective Time until the eighteen (18) month anniversary of the Closing Date notwithstanding any investigation made by or on behalf of any party. The representations and warranties made by Radware and Parent in this Agreement shall survive the Effective Time until the eighteen (18) month anniversary of the Closing Date notwithstanding any investigation made by or on behalf of any party. Notwithstanding anything herein to the contrary, the representations and warranties made in Sections 3.04, 3.14, and 4.02 shall survive the Effective Time until the expiration of all relevant statutes of limitations.

SECTION 9.02 Notices. All notices and other communications given or made pursuant hereto shall be in writing and shall be deemed to have been duly given or made as of the date received if delivered personally, on the day after sending if sent by nationally recognized overnight courier or the third day after mailing if mailed by registered or certified mail (postage prepaid, return receipt requested) to the parties at the following addresses (or at such other address for a party as shall be specified by like changes of address, which shall be effective upon receipt), or on the date of sending if sent by electronic transmission, with confirmation received, to the telecopy numbers specified below:

If to Parent

Radware, Ltd.
22 Raoul Wallenberg Street
Tel Aviv 69710
Israel
Attn: Vice President of Legal Affairs
Facsimile: 972-3-7668982

With a copy to (which shall not constitute notice):

Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036
Attn: Ernest S. Wechsler, Esq.
Facsimile: 212-715-8000

If to Radware [or Merger Sub]:

Radware, Inc.
c/o Radware, Ltd.
22 Raoul Wallenberg Street
Tel Aviv 69710
Israel
Attn: Vice President of Legal Affairs
Facsimile: 972-3-7668982

With a copy to (which shall not constitute notice):

Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036
Attn: Ernest S. Wechsler, Esq.
Facsimile: 212-715-8000

If to the Company:

Covelight Systems, Inc.
6501 Weston Parkway
Suite 355
Cary, NC 27513
Attn: Chief Executive Officer
Facsimile: 412-809-4201

With a copy to (which shall not constitute notice):

Wyrick Robbins Yates & Ponton LLP
4101 Lake Boone Trail
Suite 300
Raleigh, NC 27607
Attn: W. David Mannheim
Facsimile: (919) 781-4865

If to the Sellers Representative, the address set forth on the signature page hereto or such other person appointed pursuant to Section 9.16.

With a copy to (which shall not constitute notice):

Wyrick Robbins Yates & Ponton LLP
4101 Lake Boone Trail
Suite 300
Raleigh, NC 27607
Attn: W. David Mannheim
Facsimile: (919) 781-4865

SECTION 9.03 Waiver. Radware may, with respect to the Company, and the Company or both Sellers Representatives may, with respect to Radware, Parent or Merger Sub, (a) extend the time for the performance of any of its obligations or other acts, (b) waive any inaccuracies in its representations and warranties contained herein or in any document delivered pursuant hereto or (c) waive compliance with any of its agreements or conditions contained herein. Any such extension or waiver shall be valid if set forth in an instrument in writing signed by the party or parties to be bound thereby.

SECTION 9.04 Headings. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

SECTION 9.05 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of Law or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner to the end that transactions contemplated hereby are fulfilled to the extent possible. To the extent that any or all provisions of this Agreement are not binding on any of the parties hereto, such provisions shall nevertheless remain in full force and effect and be binding on all the other parties hereto.

SECTION 9.06 Entire Agreement; Amendment. This Agreement (including any exhibits and schedules hereto), the Company Disclosure Schedule, the Ancillary Agreements and the Confidentiality Agreement constitute the entire agreement among the parties hereto and supersede all prior and contemporaneous agreements and undertakings, both written and oral, among the parties, or any of them, with respect to the subject matter hereof. This Agreement may be amended in writing executed by Radware, Parent, the Company and the Sellers Representatives, and any provision of this Agreement may only be waived by the party for whose benefit the applicable provision exists, provided that the Sellers Representatives may waive on behalf of the Company Recipients.

SECTION 9.07 Assignment. Neither this Agreement nor any of the rights, interests or obligations under this Agreement may be assigned or delegated, in whole or in part, by operation of law or otherwise by any of the parties hereto without the prior written consent of the other parties, and any such assignment without such prior written consent shall be null and void, except that Radware and/or Merger Sub may assign this Agreement to any direct or indirect wholly-owned subsidiary of Radware or Parent without consent of the Company, provided that Radware and Parent shall remain liable for all of its obligations under this Agreement. Subject to the preceding sentence, this Agreement shall be binding upon, inure to the benefit of, and be enforceable by, the parties hereto and their respective successors and permitted assigns.

SECTION 9.08 Parties in Interest. This Agreement shall be binding upon and inure solely to the benefit of each party hereto, including for purposes of Article VIII Indemnitees, and its successors and nothing in this Agreement, express or implied, is intended to or shall confer upon any other person any right, benefit or remedy of any nature whatsoever under or by reason of this Agreement.

SECTION 9.09 Failure or Indulgence Not Waiver; Remedies Cumulative. No failure or delay on the part of any party hereto in the exercise of any right hereunder shall impair such right or be construed to be a waiver of, or acquiescence in, any breach of any representation, warranty or agreement herein, nor shall any single or partial exercise of any such right preclude other or further exercise thereof or of any other right. All rights and remedies existing under this Agreement are cumulative to, and not exclusive of, any rights or remedies otherwise available.

SECTION 9.10 Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF DELAWARE.

SECTION 9.11 Counterparts. This Agreement may be executed in two (2) or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

SECTION 9.12 Waiver of Jury Trial. EACH OF THE PARTIES HERETO HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, ALL RIGHTS TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED UPON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY.

SECTION 9.13 Jurisdiction; Forum. Each of the parties hereto (i) consents to submit itself to the non-exclusive personal jurisdiction of any federal court located in the Borough of Manhattan of the State of New York in the event any dispute arises out of this Agreement or any of the transactions contemplated by this Agreement and (ii) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court.

SECTION 9.14 Definition of Knowledge. As used herein, the words “knowledge” or “known” shall, with respect to the Company, mean the actual knowledge of the persons whose names are set forth on Schedule 9.14.

SECTION 9.15 Specific Performance and Injunctive Relief. The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached or threatened to be breached. It is accordingly agreed that the parties shall be entitled to seek a preliminary and permanent injunction or injunctions to prevent breaches, or threatened breaches, of this Agreement and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, without the need to post bond or other security, this being in addition to any other remedy to which they are entitled at law or in equity.

SECTION 9.16 Appointment of Sellers Representatives.

(a) Each Company Recipient hereby irrevocably constitutes and appoints each of Intersouth VI, LP and Aurora IV, LLC as a “Sellers Representative” and (ii) irrevocably constitutes and appoints each Sellers Representative as such Company Recipient’s true and lawful agent, proxy and attorney-in-fact pursuant to this Section 9.16 and (ii) agrees to the provisions of this Section 9.16. Both Sellers Representatives shall have full power and authority to act for each Company Recipient and in each Company Recipient’s name, place and stead, and in any and all capacities to do and perform every act and thing required or permitted to be done in connection with the transactions contemplated by this Agreement and the Escrow Agreement upon and immediately following the Effective Time, as fully to all intents and purposes as such Company Recipient might or could do in person, including, without limitation, all decisions relating to the defense and/or settlement of any claims for which any Radware Indemnitee may claim to be entitled to indemnity pursuant to Article VIII hereof, the amendment of this Agreement, the receipt of all payments and notices and the giving of all consents and waivers. All decisions and actions by both Sellers Representatives shall be binding upon all of the Company Recipients, and no Company Recipient shall have the right to object to, dissent from, protest or otherwise contest the same.

(b) Each Company Recipient hereby agrees that (i) the provisions of this Section 9.16 are independent and severable, are irrevocable and coupled with an interest and shall be enforceable notwithstanding any rights or remedies any Company Recipient may have in connection with the transactions contemplated by this Agreement, (ii) the remedy at law for any breach of the provisions of this Section 9.16 would be inadequate, (iii) Radware shall be entitled to temporary and permanent injunctive relief without the necessity of proving damages if Radware brings an action to enforce the provisions of this Section 9.16 and (iv) the provisions of this Section 9.16 shall be binding upon the heirs, successors and assigns of each Company Recipient.

(c) Any notice or communication delivered by Radware, Merger Sub or the Surviving Corporation to both Sellers Representatives shall, as between Radware, Merger Sub and the Surviving Corporation, on the one hand, and the Company Recipients, on the other, be deemed to have been delivered to all Company Recipients. Radware, Merger Sub and the Surviving Corporation shall be entitled to rely exclusively upon any communications or writings given or executed by both Sellers Representatives and shall not be liable in any manner whatsoever for any action taken or not taken in reliance upon the actions taken or not taken or communications or writings given or executed by both Sellers Representatives. Any Company Recipient that wishes to deliver any notice, or take any other action with respect to any matter arising, under this Agreement must do so through the Sellers Representatives, and Radware, Merger Sub and the Surviving Corporation shall be explicitly entitled to disregard any notices or communications given or made by the Company Recipients unless given or made through the Sellers Representatives, and such notices or communications shall be of no force or effect.

(d) Each Company Recipient acknowledges that the Sellers Representatives are acting as his, her or its agent as set forth above and each agrees to severally, in proportion to its Pro Rata Interest, indemnify and hold harmless and defend each Sellers Representative, his agents and assigns (collectively, the “Indemnitees”), against all liabilities, claims, actions, damages, losses and expenses (including, without limitation, legal and other professional fees and expenses, and litigation costs) of any kind (whether known or unknown, fixed or contingent) arising out of or in connection with (i) the Sellers Representative’s omissions to act, or actions taken, resulting from, arising out of, or incurred in connection with, or otherwise with respect to this Agreement and the Escrow Agreement, or (ii) services taken with respect to this Agreement and the Escrow Agreement or believed to be in the scope of the Indemnatee’s authority, provided that the Indemnatee in question has not acted with intentional misconduct or fraud.

(e) The Sellers Representatives may consult with legal counsel, independent public accountants and other experts selected by both Sellers Representatives. The Sellers Representatives shall not be responsible or liable to any Company Recipient for any act or omission of any kind so long as he has acted in good faith (any such action or omission pursuant to an order, judgment or decree of any court or administrative agency, or advice of legal counsel, public accountants and other experts selected by the Sellers Representative shall be conclusive evidence of such good faith), or for the expiration of rights under any statute of limitations with respect to this Agreement and the Escrow Agreement.

(f) Upon and after the Effective Time, in the case of the unwillingness to serve or other unavailability of a Sellers Representative, the Company Recipients who receive a majority of the Net Aggregate Merger Consideration shall have the right, exercisable by written notice to Radware and the Escrow Agent, to designate a replacement Sellers Representative.

SECTION 9.17 QUARTERLY NET REVENUE UPDATES. From and after the Effective Time, Radware and Parent shall deliver to the Sellers Representatives quarterly statements detailing the Net Revenue (used to calculate the Additional Payment under this Agreement) recognized in each three month period from the Effective Time, with a schedule showing the products from the Inflight and Percept Product Line sold and the prices charged for such products, within forty (40) days of the end of each such period. It is understood that such updates are subject to adjustment in the ordinary course of business and only the final determination of the Additional Payment pursuant to Section 2.08 will be binding on the parties.

SECTION 9.18. PARENT GUARANTY. Parent does hereby absolutely and unconditionally guarantee to each Company Recipient and its successors and assigns the due and punctual payment of all amounts payable and performance of all obligations by Radware under this Agreement. Parent expressly waives presentment, demand, protest, and notice of dishonor of any such payments and obligations. This obligation and liability on the part of the Parent shall be primary and not secondary, payable immediately upon demand without recourse first having been had by any Company Recipient against Radware. Parent covenants, warrants and represents to each Company Recipient that this guaranty is enforceable against Parent in accordance with its terms.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, each of the parties hereto has caused this Agreement to be executed as of the date first written above by a duly authorized officer or other person.

COVELIGHT SYSTEMS, INC.

By: /s/ Spencer Snedecor
Name: Spencer Snedecor
Title: CEO

RADWARE DELAWARE CORP.

By: /s/ Roy Zisapel
Name: Roy Zisapel
Title: Chief Executive Officer

RADWARE, INC.

By: /s/ Roy Zisapel
Name: Roy Zisapel
Title: Chief Executive Officer

RADWARE, LTD.

By: /s/ Roy Zisapel
Name: Roy Zisapel
Title: Chief Executive Officer

SELLERS REPRESENTATIVES:

INTERSOUTH PARTNERS VI, L.P.

By: Intersouth Associates VI, LLC, its general partner

By: /s/ Kip Frey
Kip Frey, Member acting pursuant to
power of attorney

Address: Crowe Building
406 Blackwell Street
Suite 200
Durham, NC 27701

Fax: (919) 493-6649

AURORA VENTURES IV, LLC

By: A.V. Management IV, L.L.C, its Managing Member

By: /s/ M. Scott Albert
Name: Scott Albert
Title: Manager

Address: 2525 Meridian Parkway
Suite 220
Durham, NC 27713

Fax: (919) 484-0444

COMPANY NOTEHOLDERS:

INTERSOUTH PARTNERS VI, L.P.

By: Intersouth Associates VI, LLC, its general partner

By: /s/ Kip Frey
Kip Frey, Member acting pursuant to
power of attorney

NEXTPOINT PARTNERS, L.P.

By: NextPoint GP, LLC, its general partner

By: /s/ Michael Faber
Michael Faber, Member

AURORA VENTURES IV, LLC

By: A.V. Management IV, L.L.C, its Managing Member

By: /s/ M. Scott Albert
Name: M. Scott Albert
Title: Manager

COMPANY STOCKHOLDERS:

Name of Stockholder: David Logan

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Ken Gramley

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: David Motsinger

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Acuitive, Inc.

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: James Beam

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Byron Hargett

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Doug Hester

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Sam Alsous

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Ken Brumer

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

COMPANY STOCKHOLDERS:

Name of Stockholder: Anthony Schmidt

By: /s/ Jim Ford
(signature)

Name: Jim Ford, as Attorney-in-fact as Secretary of Covelight Systems, Inc.

Title (if applicable): Attorney-in-fact as Secretary of Covelight Systems, Inc.

LIST OF SUBSIDIARIES

| <u>Name of Subsidiary</u> | <u>Country of Incorporation</u> |
|-----------------------------|--------------------------------------|
| Radware Inc. | New Jersey, United States of America |
| Radware UK Limited | United Kingdom |
| Radware France | France |
| Radware Srl | Italy |
| Radware GmbH | Germany |
| Nihon Radware KK | Japan |
| Radware Australia Pty. Ltd. | Australia |
| Radware Singapore Pte. Ltd. | Singapore |
| Radware Korea Ltd. | Korea |
| Radware Canada Inc. | Canada |
| Radware GmbH | Switzerland |
| Radware India Pvt. Ltd. | India |
| Covelight Systems, Inc.(*) | Delaware, United States of America |

(*) Purchased during 2007

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Commission File Number 333-13818, Commission File Number 333-114668 and Commission File Number 333-135218) pertaining to the Radware Ltd. 1997 Key Employee Share Incentive Plan, of our report dated January 28, 2007, with respect to the Consolidated Financial Statements of Radware Ltd., included in its Annual Report (Form 20-F) for the year ended December 31, 2006, filed with the Securities and Exchange Commission.

Tel - Aviv, Israel
June 5, 2007

/s/ Kost Forer Gabbay & Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Roy Zisapel, certify that:

1. I have reviewed this annual report on Form 20-F of Radware Ltd. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: June 5, 2007

/s/ Roy Zisapel _____
Roy Zisapel
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Meir Moshe, certify that:

1. I have reviewed this annual report on Form 20-F of Radware Ltd. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: June 5, 2007

/s/ Meir Moshe
Meir Moshe
Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Radware Ltd. (the “Company”) on Form 20-F for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Roy Zisapel, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 5, 2007

/s/ Roy Zisapel
Roy Zisapel
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Radware Ltd. (the “Company”) on Form 20-F for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Meir Moshe, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 5, 2007

/s/ Meir Moshe
Meir Moshe
Chief Financial Officer
(Principal Financial Officer)
