
**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 [FEE REQUIRED]**

OR

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the fiscal year ended December 31, 2000

OR

☐ **TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the transition period from _____ to _____
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 St., Tel Aviv 69710, Israel

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Class

None

Name of each exchange on which registered

None

Securities registered or to be registered pursuant to Section 12(g) of the Act:

Ordinary Shares, NIS 0.1 par value per share

(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:

16,321,475 Ordinary Shares, NIS 0.1 par value per share

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 which financial statement item the registrant has elected to follow.

☐ Item 17 ☒ Item 18

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 Report 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 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.

As used in this annual report, the terms "we," "us," "our," and "RADWARE" mean RADWARE Ltd. and its subsidiaries, unless otherwise indicated.

We have registered trademarks for "Web Server Director®," "Cache Server Director®" and "Triangulation®" and we have trademark applications pending for "FireProof™," "LinkProof™," "Synapps-Architecture™," "Smart Nat™," "CertainT™," "Get Certain™" and "BandRacer™." All other trademarks and tradenames appearing in this annual report are owned by their respective holders.

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PART 1**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**

We have derived the following selected consolidated financial data presented below from our consolidated financial statements and notes included in this annual report. You should read the selected consolidated financial data together with the section of this annual report entitled “Operating and Financial Review and Prospects” and our consolidated financial statements included elsewhere in this annual report. Please see notes 2L and 12D of the notes to our consolidated financial statements for an explanation regarding the computation of basic and diluted net income (loss) per ordinary share.

	April 1, 1997 (Commencement of activity) through December 31, 1997	Year ended December 31, 1998	Year ended December 31, 1999	Year ended December 31, 2000
	(In thousands, except per share data)			
Statement of Operations Data:				
Sales	\$1,159	\$ 4,900	\$14,141	\$38,353
Cost of sales	<u>599</u>	<u>899</u>	<u>2,269</u>	<u>6,123</u>
Gross profit	<u>560</u>	<u>4,001</u>	<u>11,872</u>	<u>32,230</u>
Operating expenses:				
Research and development expenses	411	1,081	2,099	5,465
Less — participation by the Chief Scientist of the Government of Israel ..	<u>—</u>	<u>341</u>	<u>466</u>	<u>—</u>
Research and development expenses, net ...	411	740	1,633	5,465
Marketing and selling expenses, net	248	4,205	9,678	24,622
General and administrative expenses	<u>142</u>	<u>298</u>	<u>1,137</u>	<u>3,127</u>
Total operating expenses	<u>801</u>	<u>5,243</u>	<u>12,248</u>	<u>33,214</u>
Operating loss	(241)	(1,242)	(576)	(984)
Financing income (expenses), net	<u>9</u>	<u>(11)</u>	<u>856</u>	<u>7,434</u>
Net income (loss) before taxes on income ..	(232)	(1,253)	280	6,450
Taxes on income	<u>—</u>	<u>—</u>	<u>—</u>	<u>387</u>
Net income (loss) after taxes on income ...	(232)	(1,253)	280	6,063
Minority's interest	<u>—</u>	<u>—</u>	<u>—</u>	<u>23</u>
Net income (loss)	<u>\$ (232)</u>	<u>\$ (1,253)</u>	<u>\$ 280</u>	<u>\$ 6,086</u>
Basic net income (loss) per ordinary share ..	<u>\$ (0.04)</u>	<u>\$ (0.16)</u>	<u>\$ 0.03</u>	<u>\$ 0.38</u>
Diluted net income (loss) per ordinary share ..	<u>\$ (0.04)</u>	<u>\$ (0.16)</u>	<u>\$ 0.02</u>	<u>\$ 0.35</u>
Weighted average number of ordinary shares used in computing basic net income (loss) per ordinary share	6,350	7,778	11,175	15,874
Weighted average number of ordinary shares used in computing diluted net income (loss) per ordinary share	6,350	7,778	12,472	17,602
		December 31,		
		<u>1998</u>	<u>1999</u>	<u>2000</u>
Balance Sheet Data:				
Cash and cash equivalents		\$1,677	\$68,747	\$130,824
Working capital		2,507	68,303	132,418
Total assets		3,833	74,734	150,095
Shareholders' equity (deficit)		2,705	69,419	135,931

Risk Factors

Our business, operating results and financial condition could be seriously harmed due to any of the following risks. The trading price of our ordinary shares could decline due to any of these risks.

We have a limited operating history, which may limit your ability to evaluate our business.

We commenced operations in April 1997 and therefore have a limited operating history. This may limit your ability to evaluate our prospects due to:

- our limited historical financial data;
- our unproven potential to generate significant operating profits; and
- our limited experience in addressing emerging trends that may affect our business.

You should consider our prospects in light of the risks, expenses and difficulties we may encounter as an early stage company in the new and rapidly evolving market for Internet traffic management solutions. Our financial success will depend on our ability to address these factors, including our ability to:

- successfully market our Web Server Director, FireProof, Cache Server Director, LinkProof and CertainT product lines;
- maintain and expand our market share in the highly competitive market for Internet traffic management solutions;
- timely and effectively introduce new products and product enhancements that are responsive to the needs of our customers; and
- attract, train and retain qualified sales, technical and customer support personnel.

We discuss these and other risks in more detail below.

Our profits for the year 2000 were generated from financing income, and there is no assurance we will continue to be profitable in the future.

We reported net income of approximately \$6.1 million for the year ended December 31, 2000 and approximately \$0.3 million for the year ended December 31, 1999. We had operating losses for those years, and our profits were derived from financing income. We cannot assure that we will remain profitable.

Our quarterly financial performance is likely to be volatile in the future because of the factors discussed below and seasonal fluctuations in our sales.

Our quarterly operating results have varied significantly in the past and are likely to continue to vary significantly in the future. Fluctuations in our quarterly financial performance may result from the factors discussed in this Risk Factors section of this Annual Report, including, for example, our limited order backlog, our dependence upon our suppliers, our need to develop and introduce new and enhanced products and the long sales cycles and implementation periods of our products. 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 in each quarter since inception, these fluctuations may not be apparent from our historical financial statements. However, we believe that our sales and sales growth from period to period 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 they might otherwise attain during the third quarter because of the slowdown in business activities during the summer months in Europe and that our sales during the fourth quarter 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.

Unless our revenues grow in excess of our increasing expenses, we will not be profitable.

Our revenues may not continue to grow or even continue at their current level. In addition, we intend to increase our operating expenses, especially our marketing and selling expenses and our research and development expenses. The precise amount of this increase will depend upon several factors, including the market situation and the results that our initial expenditures produce. We will make these expenditures in anticipation of generating higher revenues, but there will be a delay in realizing higher revenues even if we are successful. If our revenues do not increase as anticipated or if expenses increase at a greater pace than revenues, we may not be profitable or, if we are profitable, we may not be able to sustain or increase profitability on a quarterly or annual basis.

If the Internet does not continue to expand as a widespread medium for commerce and communications, demand for our products may decline significantly.

Our future success depends on the continued growth of the Internet as a widely used medium for commerce and communication. If use of the Internet does not continue to expand, the growth of the market for Internet traffic management solutions may not continue and the demand for our products could decline significantly.

If the market for Internet traffic management solutions does not continue to develop, we will not be able to sell enough of our products to achieve profitability.

The Internet traffic management market is new and rapidly evolving and we cannot assure you that it will continue to develop and grow. Market acceptance of Internet traffic management solutions is not proven and 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 Internet traffic management solutions does not continue to grow, we will not sell enough of our products to achieve profitability.

Our success depends on the market acceptance and increased sales of our Web Server Director product line, which currently accounts for approximately 50% of our revenues, and other product lines.

We currently derive approximately 50% of our revenues from our Web Server Director product line. Our future financial performance will depend significantly on the successful marketing and market acceptance of this product line, as well as our FireProof, Cache Server Director and LinkProof product lines and other new products. Implementation of our strategy depends upon our products being able to solve the network availability and performance problems of our customers. If our products are unable to solve these problems for our customers, the market may not maintain its interest in our products, which will reduce our revenues and our profitability.

Competition in the market for Internet traffic management solutions is intense. As a result, we may lose market share and we may be unable to achieve or maintain profitability.

Our market is highly competitive and we expect competition to intensify in the future. We may not be able to compete effectively in our market and we may lose market share to our competitors. Our principal competitors in the market for Internet traffic management solutions include Nortel (which purchased one of our competitors, Alteon WebSystems Inc., during the last year), Cisco Systems, Inc., F5 Networks, Inc., Foundry Inc. and Resonate, Inc. We also compete with other providers of hardware and software that offer solutions to network infrastructure problems. 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 Internet traffic management solutions and emerge as significant competitors. 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 or maintain profitability.

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

Some of our competitors have greater financial, personnel and other resources than we do, 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 or bundle their products or incorporate an Internet traffic management component into existing products in a manner that renders our products partially or fully obsolete, thereby discouraging customers from purchasing our products.

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

The market for Internet traffic management solutions is 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 market acceptance of our products.

We are currently developing new products, new product lines and enhancements to our existing products. We may not be able to successfully complete the development and market introduction of new products, product lines or product enhancements. If we fail to develop and deploy new products, product lines and product enhancements on a timely basis, our revenues will decline and we may lose market share to our competitors.

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

We have a limited order backlog, which makes revenues in any quarter substantially dependent on orders received and delivered in that quarter. A delay in the recognition of revenue, even from one customer, 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. 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 our ultimate customers. We currently have over 200 independent distributors that sell our products. We are highly dependent upon our distributors' active marketing and sales efforts. Our distribution agreements generally are non-exclusive and are for a one-year term with no obligation 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 or product lines and we may not succeed in doing so. Any changes in our distribution channels, particularly the loss of a significant number of our distributors 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 and implementation periods, which increases 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. Prospective customers generally must make a significant commitment of resources to test and evaluate our products and to integrate them into larger systems. 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 attempting to make sales.

Long-sales cycles also subject us to risks not usually encountered in a short sales span, including customers' budgetary constraints, internal acceptance reviews and cancellation. In addition, orders expected in one quarter could shift to another because of the timing of customers' procurement decisions. Furthermore, customers may defer orders in anticipation of new products or product enhancements introduced by us or by our competitors. This complicates our planning processes and reduces the predictability of our earnings.

We must manage our expansion and anticipated growth effectively in order to attain profitability.

We are actively expanding our operations in order to gain market share in the evolving market for Internet traffic management solutions. This expansion has placed, and will continue to place, a significant strain on our managerial, operational and financial resources.

We cannot assure you that:

- we have made adequate allowances for the costs and risks associated with this expansion;
- our systems, procedures or controls will be adequate to support our operations; or
- we will be able to offer and expand our products successfully.

Any delay in implementing, or transitioning to, new or enhanced systems, procedures or controls may seriously harm our ability to forecast sales demand accurately, manage our product inventory and record and report financial and management information on a timely and accurate basis. 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.

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

Our products require a sophisticated marketing and sales effort targeted at several levels within a prospective customer's organization. We have expanded our worldwide marketing and sales staff, especially in our new subsidiaries in Europe and Australia, and we plan to continue and increase our marketing and sales staff, including our sales, technical and customer support personnel, especially in our subsidiaries. We also plan to significantly increase our research and development staff during 2001. Competition for qualified sales personnel is intense and we may not be able to hire sufficient sales personnel to support our marketing efforts.

As we grow, we will need to increase our staff to support new customers and the expanding needs of existing customers as well as our continued research and development operations. The installation of Internet traffic management solutions, the integration of these solutions into existing networks and ongoing support can be complex. Accordingly, we need highly-trained technical and customer support personnel. Hiring technical and customer support personnel is very competitive in our industry, due to the limited number of people available with the necessary technical skills and understanding of our products. Our success depends upon our ability to attract, train and retain highly qualified technical and customer support personnel.

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

Undetected hardware 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 errors when first introduced or when new versions are released, either due to errors we fail to detect or errors in components supplied by third parties. These errors tend to be found from time to time in new or enhanced products after the commencement of commercial shipments. 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 errors, we will need to divert the attention of our engineering personnel from our product development efforts to address the detection of the errors. In the past, we have not incurred significant warranty or repair costs, been subject to liability claims for damages related to product errors or experienced any material lags or delays as a result of these errors. 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, whether caused by our products or the products of another vendor, may result in significant customer relations problems and injury to our reputation and may impair the market acceptance of our products.

If RAD Operation Services Ltd. is not able to provide us with adequate supplies of the principal component used in our products, we will not be able to deliver sufficient quantities of our products to satisfy demand.

We rely on RAD Operation Services Ltd. (formerly RAD Network Devices Ltd.), an affiliated entity controlled by Messrs. Yehuda and Zohar Zisapel, who are co-founders and principal shareholders of our company, to supply us with circuit boards. Mr. Yehuda Zisapel is also our chairman of the board. These circuit boards are the principal component which we use in the manufacture of our products. Should we be unable to acquire circuit boards from RAD Operation Services on acceptable terms or should RAD Operation Services 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. Any transition to one or more alternate suppliers would likely result in delays, operational problems and increased expenses and may limit our ability to deliver our products to our customers on time for such transition period.

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. We do not have any issued patents for any of our technology. In the United States, we have registered trademarks for "Web Server Director®," "Cache Server Director®" and "Triangulation®" and we have trademark applications pending for "FireProof™," "LinkProof™," "Synapps Architecture™," "Smart Nat™," "CertainT™," "Get Certain™" and "BandRacer™", and pending patent applications for the use of our proprietary proximity detection system for our global load balancing used in our Web Server Director product line, for smart content routing used in our LinkProof product line and for traffic distribution control to be used in our future 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. Further, defending our intellectual property rights could result in the expenditure of significant financial and managerial resources.

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. Any infringement claim, even if not successful, could result in the expenditure of significant financial and managerial resources.

Our non-competition agreements with our employees may not be enforceable. 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. Pursuant to current U.S. and Israeli law, we may not be able to enforce such non-competition agreements. In the event that we are unable to enforce any of these agreements, our competitors that employ our former employees could benefit from the expertise our former employees gained while working for us.

Our efforts to increase our presence in additional markets may not be profitable.

We currently offer our products in over 50 countries in addition to North America and we intend to enter additional geographic markets and to continue to expand our sales efforts worldwide. In 1999 and 2000, our sales outside North America represented 43.9% and 52.9% of our total sales. Our ability to penetrate new markets is subject to risks inherent to these markets. These risks may impair our ability to generate profits from our increased sales efforts outside North America. Any future political or economic instability in these or other foreign countries could significantly reduce demand for our products.

We are controlled by Messrs. Yehuda and Zohar Zisapel who beneficially own approximately 26.7% of our ordinary shares and may therefore be able to elect all of our directors and exercise control over the outcome of matters requiring shareholder approval.

One of our directors, Mr. Yehuda Zisapel, and Zohar Zisapel, a former director and the brother of Mr. Yehuda Zisapel, beneficially own an aggregate of 4,351,608 ordinary shares, representing approximately 26.7% of the ordinary shares currently outstanding (according to 13-G filings for December 31, 2000). In addition, Roy Zisapel, Yehuda Zisapel's son, is our Chief Executive Officer and President and a director, and he owns 300,000 ordinary shares and options to purchase 620,573 ordinary shares, of which 507,173 are fully vested. In addition, Messrs. Yehuda and Zohar Zisapel control the right to vote the ordinary shares issuable upon exercise of options while held by the trustee under our share option plan. As a result, these shareholders may control the outcome of various actions that require shareholder approval. For example, these shareholders could elect all of our directors, delay or prevent a transaction in which shareholders might receive a premium over the prevailing market price for their shares and prevent changes in control or management.

We do not intend to pay dividends.

We have never declared or paid any cash dividends on our ordinary shares. We currently intend to retain any future earnings to finance operations and to expand our business and, therefore, do not expect to pay any cash dividends in the foreseeable future.

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 may be characterized as a passive foreign investment company for U.S. federal income tax purposes. Our passive income would not include income derived from the sale of our products but would include amounts derived by reason of the temporary investment of the proceeds of our two public offerings. This characterization could result in adverse U.S. tax consequences to our shareholders, including having gain realized on the sale of our shares be 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. For a discussion of how we might be characterized as a passive foreign investment company and related tax consequences, please see the section of this annual report entitled Taxation and Foreign Exchange Regulation — United States Federal Income Tax Considerations.”

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. Political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been an increased level of hostilities and violence between Israel and the Palestinians, which has adversely affected the peace process and has negatively influenced our relationship with several Arab countries. We could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation, or a significant downturn in the economic or financial condition of Israel. Several Arab countries still restrict business with Israeli companies. We could be adversely affected by restrictive laws or policies directed towards Israel or Israeli businesses.

Most of our directors and officers 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.

Our directors, officers and employees who are male adult citizens and permanent residents of Israel under the age of 48, including Roy Zisapel, our Chief Executive Officer and President, Meir Moshe, our Chief Financial Officer, Amir Peles, our Chief Technical Officer, and Assaf Ronen, our Vice President, Research and Development, are, unless exempt, obligated to perform annual military reserve duty and are subject to being called to active duty at any time under emergency circumstances. We cannot assess the full impact of these requirements on our workforce or business if conditions should change and we cannot predict the effect on us of any expansion or reduction of these obligations.

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

All 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 Israel, in New Israeli Shekels (NIS). As a result, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the dollar or that the timing of this devaluation lags behind inflation in Israel, or in case the NIS rises in value relative to the dollar. In that event, the dollar cost of our operations in Israel will increase and our dollar-measured results of operations will be adversely affected. In 2000, there was an increase in value of the NIS in relation to the dollar of 2% and no inflation. This trend did not materially affect us, but we cannot assure you that we will not be materially adversely affected in the future if the NIS rises in value relative to the dollar or if the rate of inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of this devaluation lags behind increases in inflation in Israel.

The tax benefits we currently receive require us to satisfy prescribed conditions and may be terminated or reduced in the future. This would increase taxes.

The Investment Center has granted us an approval to establish an "approved enterprise" program at our manufacturing facility. Although we do not currently have an approved enterprise program, we have made the necessary capital investments to establish an approved enterprise program. Once it is established, our income derived from this approved enterprise program will be exempt from tax for a period of two years and will be subject to a reduced tax for an additional five years. 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, we may be required to pay additional taxes for the period in which we benefited from the tax exemption or reduced tax rates and would likely be denied these benefits in the future. From time to time, the Government of Israel has discussed reducing or eliminating the benefits available to approved enterprise programs. We cannot assure you that we will meet the requirements for such tax benefits or that these tax benefits will be continued in the future at their current levels or at all.

It may be difficult to enforce a U.S. judgment against us, our officers and directors and the Israeli accountants named as experts in this annual report or to assert U.S. securities laws claims in Israel or serve process on substantially all of our officers and directors and these accountants.

We are incorporated in Israel. Substantially all of our executive officers and directors and the Israeli accountants named as experts in this prospectus are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for an investor, or any other person or entity, to enforce a U.S. court judgment based upon the civil liability provisions of the U.S. federal securities laws in an Israeli court against us or any of those persons or to effect service of process upon these persons in the United States. Additionally, it may be difficult for an investor, or any other person or entity, to enforce civil liabilities under U.S. federal securities.

Since the market for Internet traffic management solutions is dependent on the growth of the Internet as a medium for commerce and communications, if the market demand for these solutions declines, our revenue and profitability are likely to decline.

We derive, and expect to continue to derive, a significant amount of revenue from the sale of our products offering Internet traffic management solutions. If the long-term growth in demand for such solutions does not occur as we expect, the demand for our Internet traffic management solutions may decline or grow more slowly than we expect. As a result, we may not be able to grow our business and our revenue and profitability may decline from current levels. The demand for Internet traffic management solutions and the products used in these solutions are affected by various factors, many of which are beyond our control. For example, general economic conditions have recently adversely affected the overall rate of capital spending by service providers, e-commerce and Internet businesses. We cannot predict the extent to which this softening of demand will continue and whether it will affect demand for our products. Further, increased competition among Internet traffic management solutions providers may lead to overcapacity and falling prices.

Item 4. Information on the Company**History and Development of the Company**

Radware 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 St., Tel-Aviv 69710, Israel and our telephone number is 972-3-766-8666. 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 North America and is our authorized representative and agent in the United States. Radware Inc. is located at 575 Corporate Dr. Suite 205, Mahwah, NJ 07430 and its telephone number is 201-512-9771. In 2000, we established subsidiaries in France, Germany, Sweden, the United Kingdom, the Netherlands and Australia, and a representative office in China, and in 2001 we established a subsidiary in Italy. The purpose of our subsidiaries and representative office is to conduct promotion and marketing activities as well as provide customer support in these regions.

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 Internet traffic management solutions that enable continuous access to Web sites and other services, applications and content based on the Internet protocol. We offer a broad range of solutions to service providers, e-commerce businesses and corporate enterprises. These organizations require uninterrupted availability and optimal performance of IP-based applications that are critical to their business.

Our Internet traffic management solutions enable our customers to manage their network infrastructure to bypass systems failures and to scale their network infrastructure to accommodate increasing IP traffic. Our products improve the productivity of network infrastructure by distributing traffic within a network to optimize the use of available network resources. Our products can be deployed either as independent solutions to address specific application needs at a particular location within a network or as an end-to-end integrated solution to manage traffic throughout a network.

Products

We offer our customers a diversified range of products that address different Internet traffic management needs. Our product lines enable our customers to enjoy continuous availability of their network resources by improving the network's fault tolerance, or resistance to software and hardware errors and system failures. In addition, our product lines provide scalability by enabling customers to expand capacity as traffic volumes dictate without having to upgrade or replace existing network resources. Our solutions can be implemented to optimize the functionality of various network resources, principally server farms providing Internet protocol applications, including Web sites, file transfer sites, e-mail servers, database servers, cache servers and firewalls. Our products can be deployed either as independent solutions to address specific application needs at a particular location within a network or as an end-to-end integrated solution to manage traffic throughout a network.

We currently offer five product lines, each designed to provide Internet traffic management solutions for different areas of the networks:

- *Web Server Director*® distributes IP traffic among multiple servers and applications to enable continuous access to the servers and to optimize utilization of available capacity.
- *FireProof*™ manages IP traffic to and from network security filters, such as firewalls, and other network resources to maximize the reliability and efficiency of these resources.

- *Cache Server Director*® redirects end-user requests, when appropriate, to cache servers which store, or cache, content previously retrieved from the Internet, thereby optimizing performance, improving response time and conserving bandwidth.
- *LinkProof*™ manages Internet traffic for networks, commonly referred to as multi-homed networks, which access the Internet through multiple connections, generally via several Internet service providers (ISPs).
- *CertainT*™ a family of products that provides real-time data processing services without disrupting the traffic flow. Currently, we released the first product in the CertainT family, the CertainT100 — SSL Accelerator, which performs SSL encryption and decryption calculations.

Each of our products is designed as a separate hardware unit that is dedicated to providing Internet traffic management solutions. These separate dedicated units are added to existing network structures and, because they do not need to be installed into any existing network devices, are capable of supporting networks ranging in size and traffic flow. Other software and PC-based solutions which are installed in a network's existing devices depend on the reliable operation of the underlying components and operating system of the device into which they are installed. This can be an independent source of system failure due to failed hard drives and the like, and reduces overall mean time between failure, the length of time an end-user may reasonably expect a device or system to function before an incapacitating fault occurs. By deploying separate dedicated hardware units that do not need to be installed into any existing network devices, we avoid introducing an independent source of system failure and help to increase the mean time between failure of our customers' networks.

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, e-mail, voice, video, database and file transfers. This enables organizations to continue to utilize and build upon their existing infrastructure without limiting their options to meet future network needs. Our products are designed to be easily and quickly installed without impact to an existing network structure.

All of our products can be combined within a single network infrastructure. For example, a typical Web Server Director network is comprised of Web Server Director-Pro units combined with Web Server Director for Distributed Sites units or Web Server Director for Network Proximity units. The same network can also deploy FireProof, LinkProof and Cache Server Director units, all of which can be managed from a single access point anywhere within the network.

We periodically provide software upgrades to our products, which are electronically sent to our customers and automatically uploaded onto our products.

On August 2000 we released a new hardware platform for our products — the Application Switch. The Application Switch is based on a multi-layered switching architecture, and enhances the performance of our products.

Web Server Director Product Line

The Web Server Director product line is available in three models:

- *Web Server Director-Pro/Web Server Director-Pro+*;
- *Web Server Director for Distributed Sites*; and
- *Web Server Director for Network Proximity*.

Each of these models is designed to address different network environments, ranging from a single group of servers organized in a farm to multiple groups of server farms with each server farm located at a different, geographically dispersed site in the network.

The Web Server Director product line can provide local or global traffic management:

- *Local Solution.* As a local solution, Web Server Director intercepts traffic directed to a local server farm and distributes the traffic among the servers in the farm, in order to bypass any off-line servers within the server farm, provide continuous availability of the applications provided by the server farm and optimize use of the capacity of the servers organized in the farm.
- *Global Solution.* As a global solution, Web Server Director can distribute traffic among multiple groups of server farms located at geographically dispersed sites throughout a network. The Web Server Director distributes the traffic among the various server farms located at different sites throughout the network through the use of advanced measuring tools and redirection methods, balancing traffic based upon a combination of a dynamic measurement of traffic and capacity at each server farm and the response time of each server farm.

Web Server Director-Pro/Web Server Director-Pro+. The Web Server Director-Pro product line, which includes Web Server Director-Pro and Web Server Director-Pro+, offers a local traffic management solution for server farms providing continuous availability of the server farm as well as optimizing and enhancing the server farm performance. Web Server Director-Pro and Web Server Director-Pro+, which replaced the earlier Web Server Director product model, offer high-speed performance designed for the most demanding applications and busiest Web sites. While Web Server Director-Pro and Web Server Director-Pro+ offer the same functionalities, Web Server Director-Pro+ is capable of sending and receiving data at 2.5 times the speed of the Web Server Director-Pro.

A Web Server Director-Pro unit is installed between a server farm and the router that provides access to the Internet and acts as an intelligent interface, or gateway, to the server farm. The Web Server Director-Pro is transparent to end-users who receive responses from the server farm unaware of the intermediary role of the Web Server Director unit. Web Server Director-Pro receives all incoming IP traffic addressed to the server farm from the router and directs the traffic to the appropriate server based upon availability and current traffic capacity of each server, bypassing off-line servers and optimally distributing traffic among the available servers. Web Server Director-Pro continuously monitors all layers of the networking environment to detect failures, from the physical connections and communications lines, known as the physical layer, to the routing and transport of data, known as the network and transport layers, to the application functions requested by the end-user such as e-mail or file transfer, known as the application layer. By quickly detecting physical, network and application failures and directing traffic to those servers and applications that are functioning properly, Web Server Director-Pro helps bypass system failures and provides timely responses to end-user requests.

Web Server Director-Pro includes the following features:

<i>Single Access Address Per Server Farm</i>	End-users access the Web site by typing in a single Internet address. Web Server Director-Pro intercepts the end-user request and, based on the current traffic volumes and server capacity, distributes the traffic in real time among the available servers within the server farm. From the perspective of the end-user, Web Server Director-Pro transforms the servers within a server farm that normally would only be independently accessible through their individual Internet addresses into a server farm functionally equivalent to a single large server accessible from a single Internet address.
<i>No Single Point of Failure</i>	Web Server Director-Pro reduces the single point of failure inherent to a single large server by monitoring off-line servers and directing traffic to available resources. In addition, Web Server Director-Pro allows for the routine maintenance or upgrades of servers without disrupting service to the end-user. Through server fault detection and application monitoring, Web Server Director-Pro redistributes traffic to operational servers when a server is taken off-line for maintenance and upgrade.
<i>Customized Traffic Distribution</i>	Web Server Director-Pro offers a comprehensive selection of traffic distribution algorithms, or mathematical procedures, allowing a customer to choose

the most appropriate configuration for its unique requirements. Customers can prioritize servers within a server farm to further optimize traffic distribution, allowing Web Server Director-Pro, for example, to direct a greater proportion of the traffic to more powerful servers. Customers can also configure our products to distribute traffic among servers based on applications, for example, routing e-mail applications to select servers while routing file transfers to the remaining servers.

Monitoring and Statistics

Web Server Director-Pro dynamically monitors the network environment, compiling statistics which are used to make dynamic traffic distribution decisions. Network administrators can monitor their network capacity and the improvements realized by implementing Web Server Director-Pro through the statistics compiled by Web Server Director-Pro, including current traffic volumes, peak traffic volumes, server and Web Server Director unit utilization, attached end-users per server and number of connection failures, among other statistics.

Complete Redundancy

Two Web Server Director-Pro units can be deployed concurrently side-by-side in a parallel configuration between the router providing access to the Internet and two server farms, with each unit actively supporting one of the two server farms attached to that unit, but also acting as a secondary back-up for the other unit. If one Web Server Director-Pro unit fails, the other Web Server Director-Pro unit will service both server farms. The availability of a back-up unit that can perform the tasks of a primary unit when the primary unit fails is referred to as redundancy. This dual active unit redundancy functionality or the Web Server Director-Pro avoids the need for idle backup units that generally remain dormant and untested once installed. Alternatively, the two Web Server Director-Pro units can be configured to provide traditional back-up redundancy, with the primary unit actively supporting the server farm and the back-up unit remaining idle to provide redundancy should the primary unit fail.

Web Server Director for Distributed Sites. Building on the award-winning Web Server Director-Pro technology designed for a single location, Web Server Director for Distributed Sites is a global Internet traffic management solution, designed to manage and distribute traffic across wide area networks, such as larger intranets, extranets and Web sites, which are serviced by multiple groups of server farms at geographically dispersed sites throughout a network. Web Server Director for Distributed Sites maximizes performance of applications distributed among numerous sites throughout a network through a dynamic determination of server availability. The server availability decision is based on each site's static parameters, such as the number of servers and the capacity and power of each server at that site, and each site's dynamic parameters, such as the number of off-line servers and the current traffic capacity of the servers at that site. Each of the Web Server Director units deployed throughout the network monitors and exchanges the dynamic parameters through the use of a traffic report protocol to enable optimal utilization of server capacity and enhanced performance of IP applications.

Web Server Director for Distributed Sites transparently redirects end-users to the optimal site within the network based on continuously updated traffic volume and capacity information. Web Server Director for Distributed Sites collects network information and communicates with the other Web Server Director units in the network to determine the most available site and server farm. When an end-user request is received, Web Server Director for Distributed Sites uses this information to direct the request to a Web Server Director unit at the most available server farm, and, in turn, the Web Server Director unit at the most available server farm then directs the request to the individual server within that farm that is best able to handle the request. The end-user experiences uninterrupted access, unaware of a redirection to the alternate site.

In addition to the fault tolerance and traffic distribution capabilities found in the Web Server Director-Pro, Web Server Director for Distributed Sites includes the following features:

<i>Combined local and global functionalities</i>	Although Web Server Director for Distributed Sites is a global solution, it contains all the functionalities of the Web Server Director-Pro and acts as a local traffic management solution for the server farm situated at the site within the network where the Web Server Director for Distributed Sites unit is located. Each Web Server Director for Distributed Sites can simultaneously manage both its local server farms and the multiple groups of server farms distributed throughout the network, redirecting traffic requests to the most available site and the most available server within the server farm at that site.
<i>Dynamic traffic Redirection</i>	Traffic is dynamically redirected among each location and server farm based on the real time determination of traffic volumes and the relative capacity, power and number of servers in each farm. In addition, distribution and capacity thresholds can be user-defined to control redirection activity.
<i>Interoperability with Web Server Director family</i>	Web Server Director for Distributed Sites can be deployed in conjunction with other Web Server Director-Pro and Web Server Director for Network Proximity units at different sites throughout a global network. Web Server Director for Distributed Sites or Web Server Director for Network Proximity units are deployed at the primary locations that initially receive the end-user requests due to their global functionalities. Traffic is redirected by the Web Server Director for Distributed Sites either locally, if the local server farm has the greatest availability, or alternatively to remote locations serviced by other Web Server Director units with greater availability, where the traffic is then distributed locally among the servers in the server farm.
<i>Multiple traffic Redirection methods</i>	Web Server Director for Distributed Sites supports all IP protocols and redirects traffic using multiple redirection methods, including our patent pending Triangulation method which transparently allows an end-user to receive data from the optimal site in a global network while maintaining that end-user's communication path with the original site.
<i>Multi-level redundancy</i>	Web Server Director for Distributed Sites enables redundancy in multiple layers of the network, among sites, other Web Server Director units and individual servers.

Web Server Director for Network Proximity. Our Web Server Director for Network Proximity offers a global traffic management solution designed to identify the most appropriate site according to both site availability and network proximity of the site to the end-user. Network proximity, as opposed to physical geographic proximity, is measured by time delay, or latency, between an end-user request and site response, and network distance traveled, determined by the number of router connections, or hops, from the site to the end-user. Building on the Web Server Director for Distributed Sites global redirection functionality, Web Server Director for Network Proximity enhances end-user quality of service and response time by identifying the site that both has the greatest availability in terms of server capacity and response time and is the closest available site to the end-user in terms of network proximity.

Web Server Director for Network Proximity offers an advanced solution for customers who provide their end-users in dispersed geographic locations with local access to their Web sites or other applications distributed throughout their global network and seek to improve quality of service by optimizing response times of their Web sites and other applications. In addition, Web Server Director for Network Proximity is well suited for customers, such as service providers, seeking to minimize traffic along their primary communication lines, or backbones, and/or optimize the use of available bandwidth. This can be achieved by redirecting end-users to the optimal site in terms of network proximity, thereby minimizing traffic traversing the backbone.

Web Server Director for Network Proximity incorporates all the functionalities of Web Server Director for Distributed Sites and builds on Web Server Director for Distributed Sites by adding the ability to efficiently direct traffic based on the proximity of the site to the end-user as well as the availability of the site. As opposed to Web Server Director for Distributed Sites that redirects traffic based on site availability alone, Web Server Director for Network Proximity transparently redirects traffic to sites by means of a dual decision-making mechanism according to both network proximity to the end-user and site availability. Web Server Director for Network Proximity instructs each Web Server Director unit deployed in the network at each site to measure the latency and number of router hops back to the end-user to determine the site closest to the end-user in terms of network proximity. To calculate the optimal available site for each end-user, Web Server Director for Network Proximity uses two proprietary protocols: a proximity report protocol, which gathers information regarding proximity of the end-user to the site, and a traffic capacity report protocol, which gathers information regarding availability. We believe that Web Server Director for Network Proximity was the first commercially available product to offer traffic management based on both network proximity and site availability. Similar to Web Server Director, Web Server Director for Network Proximity can simultaneously manage both local server farms and server farms distributed throughout a global network and can be deployed in tandem with Web Server Director for Distributed Sites and Web Server Director-Pro units.

FireProof Product Line

Our FireProof product line offers an Internet traffic management solution for multiple network hardware or software security devices. For example, companies deploy network security filters, or firewalls, to protect their networks from unauthorized access to sensitive information. Firewalls act as gateways through which all incoming network traffic must pass, providing controlled access from the Internet to the data within the organization's servers in order to enforce the organization's security policy. Firewalls are often deployed in groups, or farms, to provide redundancy and increase the traffic capacity, or throughput, of the firewalls in order to overcome performance bottlenecks of individual firewall units. Similar to our Web Server Director product line, our FireProof product line is designed to direct traffic among a group of firewalls within a farm to ensure availability by avoiding off-line firewalls and to distribute traffic among available firewalls to maximize firewall capacity. Without any traffic management solution, traffic to or from the Internet that is routed through an off-line firewall will be discarded. FireProof offers continuous availability by providing full fault tolerance between firewalls by automatically routing traffic destined for an off-line firewall to the most available on-line firewall, thereby eliminating the need for additional idle standby units as backup in the event of firewall failure.

In addition, firewalls generally have limited performance capabilities when handling traffic. To accommodate growth in traffic, organizations can either upgrade to a more powerful firewall or add more units. However, a single more powerful firewall will eventually reach its full capacity. In addition, when multiple firewalls are installed, traffic load is generally not efficiently distributed among units, resulting in less than optimal use of the firewall units. FireProof enhances firewall performance by optimally distributing traffic among all available firewall units. Similar to our other product lines, FireProof offers full scalability to provide cost-effective growth. Additional firewall units can be incorporated into an organization's existing legacy equipment without the need to upgrade or replace existing firewalls.

Cache Server Director Product Line

Our Cache Server Director product line is a cache server management and traffic distribution system. Designed for organizations that employ cache server farms on their networks, Cache Server Director is designed to maximize the performance of cache server farms and provide optimal utilization of Internet access and storage resources.

Cache servers are designed to enhance the efficiency of data transmission by reducing the amount of redundant network traffic. Cache servers locally store, or cache, information previously retrieved from the Internet in dedicated storage systems. Future requests for the same information are retrieved directly from the cache server, thereby avoiding the need to traverse the entire network to retrieve the same data. Cache servers are frequently deployed in farms to provide redundancy and increased capacity. However, cache servers

generally require a time-consuming user configuration procedure. Users that are not configured to a cache server will access the Internet directly. This results in less than optimal use of cache resources, delay in response time to the cache servers and unnecessary use of bandwidth to access data that was previously cached on the local network. Cache Server Director eliminates the need to configure individual users to the cache servers. Cache Server Director intercepts outgoing Internet requests according to predefined criteria and redirects them to the cache server where the requested information has previously been stored, thereby avoiding inefficient use of bandwidth and eliminating duplication of cached information on different servers.

In addition, Cache Server Director processes requests for non-cached data and distributes information retrieved from the Internet among available cache servers for storage. Cache Server Director distributes the retrieved information proportionately among the cache servers in order to optimize capacity and performance of the entire cache server farm. To further provide for optimal utilization of cache servers, Cache Server Director monitors user requests for popular Internet addresses and automatically transfers them to the least loaded cache server.

Cache Server Director provides full fault tolerance between cache servers. Should a cache server fail, Cache Server Director will redirect all requests to another cache server within a farm, providing users with uninterrupted access to the cache server farm. Similar to our other product lines, Cache Server Director offers full scalability to enable cost-effective growth, allowing customers to employ different cache servers with varying performance capabilities within a cache server farm managed by a Cache Server Director.

LinkProof Product Line

Our LinkProof product line offers an Internet traffic management solution for multi-homed networks. In order to ensure continuous access to the Internet, enterprises frequently deploy multiple connections between their networks and the Internet, generally via several Internet service providers, providing the network with alternative access points to the Internet in the event one connection fails. This network design is commonly referred to as a multi-homed network.

Our LinkProof product line is deployed between a multi-homed network and the Internet access routers to ensure high availability and continuous access to and from the Internet as well as optimal utilization of the available Internet access connections. LinkProof acts as an intelligent interface between the multi-homed network and the Internet. LinkProof receives all outgoing Internet traffic from the network and routes the traffic to the appropriate ISP based on availability and current traffic load along the connection to the ISP. LinkProof continuously monitors the transport layer of the network environment to detect failures. In the event of a failure in a connection to one of the ISPs used by the multi-homed network, LinkProof automatically routes the traffic to an alternative ISP.

LinkProof also dynamically distributes outgoing and incoming Internet traffic through the several Internet connections available to a multi-homed network to provide optimal use of the network's Internet connections. Building on the proximity detection technology used in the Web Server Director for Network Proximity, LinkProof dynamically selects the most efficient Internet connection with respect to each Web site for either inbound or outbound Internet traffic. This technology enables LinkProof to monitor the performance of each of the ISP connections with respect to the requested Web site. Using this information, LinkProof makes the routing decision based on the availability of each Internet connection as well as the network proximity of the Internet and the requested Web site through the various ISPs, thereby providing the optimal path for Internet traffic to and from the network.

CertainT Product Family

The *CertainT*[™] family of products was designed to provide real-time data processing services without disrupting the traffic flow and creating bottlenecks.

We released the first product in the CertainT family, the CertainT100 — SSL Accelerator. The CertainT 100 relieves network web servers of performing the CPU (Central Processing Unit) intensive SSL (Secure Sockets Layer) encryption and decryption calculations associated with secure online applications. The

CertainT 100 decrypts the SSL traffic off-line and forwards it to the web servers for completion of the transaction. The CertainT 100 can process 200 SSL encryption transactions per second. To increase processing capabilities, multiple CertainT devices can be added to create CertainT 100 farms, which may accelerate the SSL encryption up to 20,000 transactions per second.

The next product to be released in the CertainT family — is the CertainT 200 — Akamaizer, which was developed in cooperation with Akamai Technologies, Inc., a provider of services for the delivery of Internet content. CertainT 200 allows customers to automatically manipulate Web content by routing users to the closest available content on the Akamai global network. We expect to release the CertainT200 by the third quarter of 2001.

SynApps Architecture™

The SynApps Architecture is sold as an add-on module to each of our product lines. It includes four components which are combined into a comprehensive Internet Traffic Management solution. The four components are: Health Monitoring; Traffic Redirection (these components existed in our products prior to the release of the SynApps Architecture); Bandwidth Management and Application Security:

Application Health Monitoring — SynApps includes health monitoring tools that check physical and logical application resources. If a problem is detected, SynApps generates the proper alerts and overcomes the problem by redirecting users to alternate resources within the local or global network. SynApps health monitoring includes tools that check: all Internet protocols, standard server agents employing Internet protocols, Transmission Control protocols, User Datagram Protocols and Web transactions, including content verification.

Traffic Redirection — Traffic redirection capabilities ensure that users are directed to healthy and available resources locally or globally despite the inherent and unpredictable peaks in Internet traffic. This module redirects traffic to the least loaded server, data center, firewall or router, thus providing resource optimization.

Bandwidth Management — SynApps Bandwidth Management allows companies to define and implement their own bandwidth management policies for applications running on servers, firewalls and cache servers as well as expensive and critical Wide Area Network connections. Bandwidth management allows companies to guarantee that critical business traffic such as ERP (Enterprise Resource Planning) traffic or e-commerce transactions receive higher priority versus non-critical traffic.

Application Security — SynApps also provides the ability to detect network intrusion and prevent dangerous malicious attacks, thereby providing another line of defense for critical network resources that are managed by Radware products. The application security module helps protect networks and applications from more than 300 known attack signatures.

ConfigWare

Our products can be managed with ConfigWare, an internally developed software management tool that is included with all of our products. ConfigWare is designed with an easy to use, graphical user interface that allows our customers to benefit from our technology with minimal technical know-how or support. ConfigWare can be installed either as a stand-alone software package or, as a Web application, in conjunction with a Web server, to enable remote configuration through a Web browser. ConfigWare enables real-time monitoring as well as historical analysis of device functionality, traffic flows and traffic volumes. It furnishes a wide range of statistics for managing servers to enable efficient utilization of the server farm, including current server traffic volumes, peak traffic volumes, attached end-users per server, and number of connection failures. Graphs and charts can be customized according to the customer's parameters. ConfigWare also enables interactive monitoring and automatic notifications of failures or other data. ConfigWare enables Web Server Director, Cache Server Director, LinkProof and FireProof software to be updated remotely while the device is working. Almost all parameter changes are implemented immediately, with no need to reset the unit.

Customers

We have a global diversified customer base consisting principally of corporate enterprises and service providers, such as telecommunication carriers, Internet service providers, application service providers and Web-hosting providers. We also offer our products to e-commerce businesses, such as e-commerce Web sites, publishing Web sites and portals, although sales to e-commerce businesses have not represented a significant portion of our revenues to date. Our range of products enables us to offer Internet traffic management solutions tailored to the varying needs of our customers to manage traffic to and from the Web servers, cache servers, e-mail servers, database servers, application servers and firewalls, both locally at a specific site within a network and globally throughout a network.

With the exception of our limited direct sales efforts to select customers, we sell our products to distributors who then resell our products to final customers. We sell our products in North America directly and through indirect distribution channels and outside North America exclusively through indirect distribution channels. In 2000 approximately 47% of our sales were in North America and 53% were outside North America, of which approximately 23% of our sales were in Europe, 28% were in Asia and Australia and 2% were in other foreign countries. Other than the United States, no single country accounted for more than 10% of our sales for 2000.

For the periods ended December 31, 1998, 1999 and 2000, no single customer accounted for more than 10% of our sales. As of December 31, 2000, one customer represented 16% of trade receivables. This customer is an affiliated Company. See "Related Party Transactions."

Sales and Marketing

Sales. We market and sell our products through an indirect sales force that consists of distributors mainly in North America, Europe and Asia. In addition, we generate direct sales to select customers in North America. Our distributors are supported by our sales managers who are also responsible for recruiting potential distributors and for initiating and managing marketing projects in their assigned regions. The sales managers are supported by our internal sales support staff who help generate and qualify leads for the sales managers. As of December 31, 2000, we employed 46 sales managers in North America with locations in various states. We also employed 33 sales managers based in Israel and other subsidiaries and representative offices, who are responsible for developing and maintaining distribution channels outside of North America. We plan to invest additional resources in expanding our distribution channels by augmenting our team of sales managers, especially local people in key countries in Europe, South America and Asia, each dedicated to an assigned geographical area. In 2000, we established subsidiaries in Australia, France, Germany, Sweden, The Netherlands and the United Kingdom, as well as a representative office in China, in order to conduct promotion and marketing activities as well as provide customer support in these regions. In 2001, we established a subsidiary in Italy.

Marketing Strategy. Our marketing strategy is to establish brand recognition and maintain our reputation as a provider of technologically-advanced, quality solutions for multiple Internet traffic management needs. 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 print and Web advertising campaigns. In addition to our independent marketing efforts, we invest in joint marketing efforts with our distributors and other companies that have formed strategic alliances with us. We have entered into co-marketing arrangements with companies in other complementary Internet segments, including Check Point Software Technologies Ltd., Network Appliance, Inc., Inktomi Corporation, WebTrends Corporation, Axent Technologies Inc, CashFlow Inc., Dimension Data I-commerce Services Limited and Compaq Computer Corp.

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 Comverse Technology, Inc., NEC and Secure Computing Corporation, as well as mutual channel

information sharing arrangements. We believe that these companies have significant customer relationships and offer products which complement our products. Our agreements allow these companies to distribute our products on a world-wide non-exclusive basis with discounts based upon the volume of orders received. Usually, there is no requirement for a minimum sales quota. The products are branded with the names of these companies or co-branded with our name as well. These agreements are either standard distributor agreements or oral agreements and are terminable by either party at will. We plan to invest further in the development of strategic alliances in order to provide greater access to our target markets and enhance our brand name.

Technical Support

Our technical support team, which consists of 44 employees worldwide as of December 31, 2000, assists our customers and distributors with the initial installation and set-up of our products, trains distributors and customers to use our products and provides software and product upgrades for our products. In addition, our technical support team trains and certifies our distributors to provide limited technical support in each of the geographical areas in which our products are sold. Our technical support team is directly responsible for remote support, including 24 hours a day, 7 days a week help-desk support through our distributors.

In order to provide our customers with a larger variety of support options and for the benefit of distributors and resellers who are unable, or unwilling, to provide high level customer support, we have developed the Certainty Support Program. The Certainty Support Program allows customers to purchase five different levels of support. The support packages include the following features: extended warranty, software upgrades, 24x7 help-desk, on-site support and unit replacement.

Our ability to provide our customers with responsive and qualified technical support and customer service is essential to attract and retain customers and build brand loyalty. We believe our technical support organizational structure enables us to provide technical support and customer service on a cost-effective and time-efficient basis.

Research and Development

In order to maintain our share of the Internet traffic management market, we place considerable emphasis on research and development to expand the capabilities of our existing products, develop new products and product lines and improve our existing technologies and capabilities. We believe that our future success will depend upon our ability to maintain our technological expertise, to enhance our existing products and to introduce on a timely basis new commercially viable products that will continue to address the needs of our customers. Accordingly, we intend to continue to devote a significant portion of our personnel and financial resources to research and development. 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 to identify market needs and to define appropriate product specifications. As of December 31, 2000, our research and development staff consisted of 51 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 R&D organization is divided according to our existing product lines. Each product line group is headed by a group leader and includes team leaders, software engineers and quality control technicians. We occasionally use affiliated companies as subcontractors for the development of portions of research and development projects.

Manufacturing and Suppliers

RAD Operation Services Ltd., an affiliated company controlled by Messrs. Yehuda and Zohar Zisapel, principal shareholders of our company, and located in Israel, manufactures the circuit boards which are the principal hardware component used in our products. RAD Operation Services supplies us with finished circuit boards for final assembly. The other components and subassemblies included in our products are supplied to RAD Operation Services from a limited group of suppliers and subcontractors. RAD Operation Services monitors each stage of the circuit board production process, including the selection of components and

subassembly suppliers. RAD Operation Services 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 RAD Operation Services. Quality assurance testing, final assembly and packaging and shipping operations are performed at our facility in Jerusalem, Israel. We believe that our quality assurance procedures have been instrumental in achieving the high degree of performance and reliability evidenced by the awards our products have won.

Proprietary Rights

We rely on patent, trademark and trade secret laws, 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, when they begin their employment with us.

We have registered trademarks for “Web Server Director®,” “Cache Server Director®” and “Triangulation®” and we have trademark applications pending for “FireProof™,” “LinkProof™,” “Synapps Architecture™,” “Smart Nat™,” “CertainT™,” “Get Certain™” and “BandRacer™.” We do not currently own any registered copyrights.

In addition, we have filed patent applications in the United States for the use of our proprietary proximity detection system for our global load balancing used in our Web Server Director product line; for smart content routing used in our LinkProof product line; and for traffic distribution control to be used in our future 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 that 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 a company’s intellectual property to the same extent as do 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

Our industry is characterized by intense competition. Our principal competitors in the sale of Internet traffic management solutions include software-based solution providers, such as Resonate and hardware-based solution providers, such as Cisco Systems, F5 Networks, Nortel (which purchased Alteon WebSystems last year) and Foundry Inc. We expect to face increasing competition as new competitors enter our market and multinational corporations purchase players in the market (such as Alteon, which was purchased by Nortel and Arrowpoint, which was purchased by Cisco).

Some of our competitors have substantially greater financial, personnel and other resources, and may offer a broader range of products than we do. These competitors may be able to respond more quickly to new or emerging technologies or changes in customer requirements. They may also benefit from greater economies of scale, offer more aggressive pricing, devote greater resources to the promotion of their products, bundle their products or incorporate an existing Internet traffic management solution into existing products, thereby discouraging customers from purchasing our products.

We believe that our success will depend primarily on our ability to provide more technologically advanced and cost-effective Internet traffic management 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.

Legal Proceedings

We are not subject to any material legal proceedings.

Investment in Wydeband Inc.

Wydeband Inc. (“**Wydeband**”) was established in Delaware in April 2000, pursuant to a company establishment agreement entered among two third parties who are not affiliated with Radware and its affiliates, for the purpose of developing, marketing and selling products and services for broadband networks.

Wydeband is engaged in development, marketing and sales of solutions for managing and delivering broadband enhanced services, such as Video-on-demand, Games-on-demand, E-learning, Video conferencing, live streaming channels and business applications. The development and management of Wydeband’s activity is performed by Wydeband Ltd., a wholly owned subsidiary of Wydeband, established in Israel.

As of December 31, 2000 Wydeband and Wydeband Ltd employed 34 employees, of which 21 were in research and development, six were in sales and marketing and seven were in management, operations and administration.

On May 9, 2000, Radware, Wydeband and Comverse Technology Ltd. (NASDAQ: CMVT) (“**Comverse**”) entered into a Convertible Debenture Purchase Agreement, pursuant to which the Company and Comverse agreed to invest in Wydeband the sum of \$3,300,300 and \$2,200,200, respectively (the “**Investment Amount**”), in consideration for convertible debentures, which may be converted into preferred shares of Wydeband.

It was agreed that the Investment Amount will be paid to Wydeband based on its cash-flow needs, as set forth in Wydeband’s business plan, within a period of 24 months. As of December 31, 2000 we invested \$721,000 of the Investment Amount.

The debentures to be owned by Radware upon full payment of the Investment Amount will be convertible into preferred shares of Wydeband which account for 57% of Wydeband’s issued and outstanding share capital, or 45.6% on a fully diluted basis.

On the same date, Radware, Comverse and Wydeband signed a Strategic Cooperation Agreement. This Agreement described the cooperation and assistance Radware and Comverse shall provide Wydeband in the field of recruiting, training, sales and marketing, and discussed the terms under which Wydeband shall sell Radware and Comverse products and vise-versa.

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 North America. In 2000, we established subsidiaries in Australia, France, Germany, Sweden, The Netherlands and the United Kingdom, as well as a representative office in China, in order to conduct promotion and marketing activities as well as provide customer support in these regions. In 2001, we established a subsidiary in Italy. All the above subsidiaries are wholly-owned, except for our subsidiary in Australia, in which we hold 75%, and 25% are held by a local Australian company.

Yehuda and Zohar Zisapel are co-founders and principal shareholders of RADWARE. Yehuda Zisapel is also the Chairman of the Board of Directors of Radware. Individually or together, they are also founders,

directors and principal shareholders of several other companies which, together with us and the other subsidiaries and affiliates, are known as the RAD-BYNET group. These corporations include:

AB-NET Ltd.	Ceragon Networks Ltd.	RADView Software Ltd.
Axerra Networks Inc.	Modules Inc.	RADVision Ltd.
BYNET Data Communications Ltd.	RADCOM Ltd.	RADWIN Ltd.
BYNET Electronics Ltd.	RAD Data Communications Ltd.	RADVision Ltd.
BYNET SEMECH (outsourcing) Ltd.	RADGuard Ltd.	RIT Technologies Ltd.
BYNET Systems Applications Ltd.	RADLAN Computer Communications Ltd.	RND Networks Ltd.
Commerce.net Ltd.	RAD Operation Services Ltd.	Sanrad Inc.
		SILICOM Ltd.

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.

Property, Plants and Equipment

As of December 1, 2000, our headquarters and principal administrative, finance and marketing and sales operations are located in approximately 23,345 square feet of leased office space in Tel Aviv, Israel. The lease expires in October 2005, and we have an option to extend the lease for an additional period of five years. The facilities are leased from affiliated companies owned by Messrs. Yehuda and Zohar Zisapel — see Item 7 — “*Major Shareholders and Related Parties Transactions*”. We also sublease from our affiliate, RAD Operation Services, approximately 2,150 square feet of space in Jerusalem for our manufacturing facility. The sublease expires in March 2004 and we have an option to renew for an additional term of five years. In the United States, we lease approximately 2,250 square feet in Mahwah, New Jersey from an affiliate, which expires in April 2002, and occupy an additional 6,000 square feet in Costa Mesa, California, under a lease that expires on February 2002. We also lease facilities for the operation of our subsidiaries and representative offices in the UK, Germany, France, Italy, the Netherlands, Sweden, Australia and China. We expect that we will need additional space as we expand our business and believe that we will be able to obtain space as needed.

Item 5. *Operating and Financial Review and Prospects*

General

We commenced operations in April 1997. Since then, we have focused on developing and enhancing our products, building our worldwide direct and indirect distribution network and establishing and expanding our sales, marketing and customer support infrastructure.

In October 1999, we completed our initial public offering of 3,500,000 ordinary shares, from which we received net proceeds of approximately \$56.8 million.

In January 2000, we completed a public offering of 1,250,000 ordinary shares, from which we received net proceeds of approximately \$60.0 million.

All 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 generally accepted accounting principles in the United States.

Revenues. Our revenues are derived primarily from sales of our products and, to a lesser extent, from sales of software upgrades and maintenance services for our products. Our product sales consist of sales of our Web Server Director, Cache Server Director and FireProof product lines. In 2000, we derived approximately 50% of our revenues from sales of our Web Server Director product line. We recognize product revenues once the product has been shipped to the customer and collection is probable. We routinely analyze and provide, as necessary, reserves at the time of shipment for product returns and allowances. We recognize revenues from the sale of Certainty Support agreements ratably over the service period.

Cost of Sales. Our cost of sales consists primarily of the cost of circuit boards and other components used in the assembly and manufacture 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.

Research and Development Expenses, Net. Research and development expenses consist primarily of salaries and related personnel expenses and prototype expenses related to the design, development, testing and enhancement of our products. 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. We expect these expenses to increase in the future as we continue to develop new products and product lines and enhance existing products.

The Government of Israel, through the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade, encourages research and development projects which result in products for export. In 1998 and 1999 we received grants from the office of the Chief Scientist for the development of our products totaling approximately \$341,000 and \$466,000, respectively. All royalties with respect to such grants were repaid in full.

Marketing and Selling Expenses, Net. Marketing and selling expenses consist primarily of salaries, commissions and related personnel expenses for those engaged in the sales, marketing and support of our products as well as related trade show, promotional and public relations expenses and royalties paid to the Government of Israel. Our success in increasing revenues depends on our ability to increase our customer base, expand our existing product lines, introduce new products and enhance our existing products, as well as the continued growth of the emerging Internet traffic management market. Accordingly, we intend to pursue sales and marketing campaigns aggressively and we therefore expect these expenses to increase in the future.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related personnel expenses for executive, accounting and administrative personnel, professional fees, bad debt expenses and other general corporate expenses. As we add personnel and incur additional costs related to the growth of our business, we expect that general and administrative expenses will also increase.

Operating expenses also include amortization of stock-based compensation, which is allocated among 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. Amortization of stock-based compensation results from the granting of stock options to employees with exercise prices per share determined to be below the deemed fair market value per share of our ordinary shares on the dates of grant. The stock-based compensation is being amortized to operating expenses over the vesting period of the individual options.

Financing Income (Expenses), Net. Financing income (expenses), net consists primarily of interest earned on bank deposits of proceeds from the issuance of our shares to the public, gains and losses from the translation of monetary balance sheet items denominated in non-dollar currencies and interest expense accrued during 1998 with respect to our convertible debentures.

Taxes. Israeli companies are generally subject to income tax at the corporate rate of 36%. However, we intend to establish an approved enterprise program which will be eligible for the tax benefits described below under the heading "Corporate Tax Rate." These benefits should result in our income being tax exempt or taxed at a lower rate for some time after we begin to report taxable income. The tax rate will depend upon the percentage of our income derived at that time from the approved enterprise program. There is no assurance we will be able to obtain such benefits.

Results of Operations

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

	Year ended December 31, 1998	Year ended December 31, 1999	Year ended December 31, 2000
Sales	100.0%	100.0%	100.0%
Cost of sales	<u>18.3</u>	<u>16.0</u>	<u>16.0</u>
Gross profit	<u>81.7</u>	<u>84.0</u>	<u>84.0</u>
Operating expenses:			
Research and development expenses, net	15.1	11.6	14.2
Marketing and selling expenses, net	85.8	68.4	64.3
General and administrative expenses	<u>6.1</u>	<u>8.1</u>	<u>8.1</u>
Total operating expenses	<u>107.0</u>	<u>88.1</u>	<u>86.6</u>
Operating loss	(25.3)	(4.1)	(2.6)
Financing income (expenses), net	<u>(0.3)</u>	<u>6.1</u>	<u>19.4</u>
Income (loss) before taxes on income	(25.6)	2.0	16.8
Taxes on income	<u>0.0</u>	<u>0.0</u>	<u>(1.0)</u>
Income (loss) after taxes on income	(25.6)	2.0	15.8
Minority's interest	<u>—</u>	<u>—</u>	<u>0.0</u>
Net income (loss)	<u>(25.6) %</u>	<u>2.0 %</u>	<u>15.8 %</u>

Year Ended December 31, 2000 Compared with Year Ended December 31, 1999

Sales. Sales in 2000 were approximately \$38.4 million, an increase of approximately 171% compared with sales of approximately \$14.1 million in 1999. The growth in sales is primarily attributable to the expansion of our sales and marketing activities, as well as the release of our new product, the LinkProof.

Cost of Sales. Cost of sales was approximately \$6.1 million in 2000, an increase of approximately 170% compared with cost of sales of approximately \$2.3 million in 1999. This increase is primarily attributable to the increase in sales. Cost of sales as a percentage of sales remained constant at 16.0% in 2000 and 1999.

Research and Development Expenses, Net. Gross research and development expenses were approximately \$5.5 million in 2000, an increase of approximately \$3.4 million compared with gross research and development expenses of approximately \$2.1 million in 1999. This increase is primarily attributable to the increase in our research and development staff. Gross research and development as a percentage of sales decreased to 14.2% in 2000 from 14.8% in 1999. We have not claimed, received or accrued in 2000, grants from the Office of the Chief Scientist of the Ministry of Industry and Trade, compared to grants received and accrued in 1999 totaling approximately \$466,000 that were applied as reductions to gross research and development expenses. Research and development expenses, net were approximately 14.2% of sales in 2000, compared with approximately 11.6% of sales, in 1999.

Marketing and Selling Expenses, Net. Marketing and selling expenses, were approximately \$24.6 million in 2000, an increase of approximately \$14.9 million compared with marketing and selling expenses of approximately \$9.7 million in 1999. This increase is primarily attributable to our aggressive expansion of marketing and selling efforts, opening new subsidiaries engaged in promotion and marketing activities, and hiring of additional marketing personnel worldwide.

General and Administrative Expenses. General and administrative expenses were approximately \$3.1 million in 2000, an increase of approximately \$2.0 million compared with general and administrative expenses

of approximately \$1.1 million in 1999. This increase is primarily attributable to the expansion of our business and expenses associated with our becoming a public company.

Financing Income (Expenses), Net. Financing income, net was approximately \$7.4 million in 2000, compared with financing income, net of approximately \$900,000 in 1999. This change is primarily attributable to the interest income in 2000 in connection with the proceeds derived from public offerings of our securities.

Year Ended December 31, 1999 Compared with Year Ended December 31, 1998

Sales. Sales in 1999 were approximately \$14.1 million, an increase of approximately \$9.2 million compared with sales of approximately \$4.9 million in 1998. The growth in sales is primarily attributable to increased shipments of our Web Server Director products and the introduction of our new Cache Server Director and FireProof product lines in the latter half of 1998.

Cost of Sales. Cost of sales was approximately \$2.3 million in 1999, an increase of approximately \$1.4 million compared with cost of sales of approximately \$899,000 in 1998. This increase is primarily attributable to the increase sales. Cost of sales as a percentage of sales declined to 16.0% in 1999 from 18.3% in 1998, primarily as a result of our decision in the third quarter of 1998 to replace the circuit board platform used in our products which we had until such date purchased from a third party original equipment manufacturer with our internally developed circuit board platform.

Research and Development Expenses, Net. Gross research and development expenses were approximately \$2.1 million in 1999, an increase of approximately \$1.0 million compared with gross research and development expenses of approximately \$1.1 million in 1998. This increase is primarily attributable to an increase in salaries and related personnel expenses and costs of raw materials used for research and development. Gross research and development as a percentage of sales decreased to 14.8% in 1999 from 22.1% in 1998. Grants from the Office of the Chief Scientist of the Ministry of Industry and Trade, totaling approximately \$466,000 and approximately \$341,000 in 1999 and 1998, are applied as reductions to gross research and development expenses. Research and development expenses, net were approximately \$1.6 million in 1999, or 11.6% of sales, compared with approximately \$740,000, or 15.1% of sales, in 1998.

Marketing and Selling Expenses, Net. Marketing and selling expenses, net, which consist of gross marketing and selling expenses after reduction of grants from the Israeli Government's Fund for the Encouragement of Marketing Activities, generally referred to as the marketing fund, were approximately \$9.7 million in 1999, an increase of approximately \$5.5 million compared with marketing and selling expenses, net of approximately \$4.2 million in 1998. This increase is primarily attributable to our aggressive expansion of marketing and selling efforts and hiring of additional marketing personnel worldwide. We did not receive any grants from the marketing fund in 1999. We received approximately \$53,000 from the marketing fund in 1998. Marketing and selling expenses, net as a percentage of sales decreased to 68.4% in 1999 from 85.8% in 1998, primarily as a result of the greater percentage increase in sales than in marketing and selling expenses, net in 1999.

General and Administrative Expenses. General and administrative expenses were approximately \$1.1 million in 1999, an increase of approximately \$800,000 compared with general and administrative expenses of approximately \$298,000 in 1998. This increase is primarily attributable to the expansion of our business and expenses associated with our becoming a public company. General and administrative expenses as a percentage of sales increased to 8.1% in 1999 from 6.1% in 1998.

Financing Income (Expenses), Net. Financing income, net was approximately \$856,000 in 1999, compared with financing expenses, net of approximately \$11,000 in 1998. This change is primarily attributable to the interest income derived from bank deposits in 1999 in connection with the private placements of our securities, compared to the interest expense we incurred on our convertible debentures in 1998. The convertible debentures were converted into preferred shares in 1998 and thus no interest was incurred on the debentures in 1999.

Liquidity and Capital Resources

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. In November 1997, we raised approximately \$4.0 million in a private placement of our convertible debentures to unaffiliated third parties. During 1998, all of the convertible debentures were converted into preferred shares. In June 1999, we raised approximately \$9.0 million in a private placement of Series B preferred shares to existing shareholders and unaffiliated third parties. In August 1999, all of our preferred shares and Series B preferred shares were converted into ordinary shares. 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 \$60.0 million in a public offering of our ordinary shares.

Our principal commitments consist of outstanding operating leases for the Company's facilities and vehicles.

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' activities, in the Netherlands, United Kingdom, Germany, France, Sweden, Italy, Australia and China. Our aggregate annual rent obligations under these leases are approximately \$905,000 for 2000 and \$911,000 for 2001.

Capital expenditures for the year ended December 31, 1998, the year ended December 31, 1999 and the year ended December 31, 2000 were approximately \$100,000, \$1.0 million and \$2.4 million, respectively. These expenditures were principally for machinery and equipment, including a CRM (Customer Relationship Management) system. We currently do not have significant capital spending or purchase commitments, but we expect to continue to engage in capital spending consistent with anticipated growth in our operations, infrastructure and personnel.

Net cash provided by operating activities was approximately \$4.7 million for the year ended December 31, 2000, compared to net cash provided by operating activities of \$2.4 million for the year ended December 31, 1999. Net cash provided by operating activities during the year ended December 31, 2000 was primarily due to our net income, partially offset by an increase in trade receivables. Net cash provided by operating activities during the year ended December 31, 1999 was primarily due to the increases in trade payables and accrued expenses, partially offset by an increase in trade receivables. Net cash used in operating activities was approximately \$1.8 million in 1998, primarily due to net losses and increases in receivables and prepaid expenses, partially offset by increases in payables and accrued expenses. Net cash used in investing activities was approximately \$129.0 million for the year ended December 31, 2000, compared to net cash used in investing activities of \$1.0 million for the year ended December 31, 1999. Cash was used during 2000 primarily to invest our cash surplus in short-term bank deposits. Net cash used in investing activities was approximately \$130,000 in 1998. Net cash provided by financing activities was approximately \$60.0 million for the year ended December 31, 2000 and approximately \$66.0 million for the year ended December 31, 1999, primarily due to our initial public offering, which generated net proceeds of approximately \$56.8 million in 1999 and our follow-on offering, which generated \$60.0 million in 2000, and from a private placement of our series B preferred shares (which were converted into ordinary shares in August 1999) that resulted in proceeds of approximately \$9.0 million. Net cash used in financing activities was approximately \$32,000 in 1998 primarily due to costs related to the issuance of preferred shares upon the conversion of all outstanding convertible debentures. As of December 31, 2000, we had cash and cash equivalents of approximately \$130.8 million, as compared to approximately \$68.7 million as of December 31, 1999. The increase was primarily due to our follow-on public offering which generated net proceeds to the Company of approximately \$60.0 million. Our capital requirements depend on numerous factors, including market acceptance of our products and the resources we allocate to our research and development efforts and our marketing and sales activities. We have experienced substantial increases in our expenditures since our inception consistent with growth in our operations and personnel and we intend to increase our expenditures for the foreseeable future in order to execute our strategy. We anticipate that operating activities, as well as capital expenditures, will demand a use of our cash resources. We believe that cash generated from operations, our unused cash balances and the net

proceeds from our public offerings 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 at least the next twelve months.

Impact of Inflation and Currency Fluctuations

The U.S. dollar cost of our operations is influenced by the extent to which any increase in the rate of inflation in Israel is offset, or is offset on a lagging basis, by the devaluation of the NIS in relation to the dollar. Because all 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 NIS, inflation in Israel will have a negative effect on our profitability unless such inflation is offset by a devaluation of the NIS, as well as an appreciation of the NIS. Conversely, devaluations of the NIS relative to the dollar at a rate in excess of the rate of inflation in Israel will have a positive effect on our profitability.

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 against the Dollar. A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities which are payable in NIS, unless these expenses or payables are linked to the dollar. This devaluation also has the effect of decreasing the dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses. Because exchange rates between the NIS 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 current operations.

Market Risk

We do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk and we have no debt.

Corporate Tax Rate

Israeli companies are generally subject to tax at the corporate tax rate of 36% of taxable income. However, the Investment Center has granted us an approval to establish an "approved enterprise" program at our manufacturing facility under the Law for the Encouragement of Capital Investments, 1959. Although we do not currently have an approved enterprise program, we have made the necessary capital investments to establish an approved enterprise program. Once it is established, our income derived from this approved enterprise program will be tax-exempt for a period of two years and will be subject for the subsequent five years to a reduced company tax of up to 25%. We expect that a substantial portion of any taxable operating income that we may realize in the future will be derived from the approved enterprise program which we intend to establish.

The approval which the Investment Center granted us is for establishing an approved enterprise program in Tel Aviv, Israel. However, our manufacturing and part of our research and development facilities are located in Jerusalem and we have, therefore, submitted a request to the Investment Center to designate our approved enterprise program for tax benefits applicable to an enterprise established and located in Jerusalem and a request to for an extension to continue the capital investments in out facility in Jerusalem during 2001. These benefits provide that income derived from the approved enterprise program allocated to the approved enterprise in Jerusalem will be tax exempt for six years and will be taxed at a reduced company tax rate of up to 25% for one additional year. The six-year tax exemption period may be extended to ten years, without an additional year of a reduced tax rate, if we apply to the Investment Center for recognition as a "High Technology" facility and this status is recognized. There is no assurance our request with respect to an approved enterprise in Jerusalem and/or our request for extension will be accepted by the Investment Center.

Government Grants

We conduct our research and development operations in Israel. Our research and development efforts have been financed through internal resources and until 1999 grants from the Chief Scientist. For the period from April 1, 1997 to December 31, 1999 the Chief Scientist provided grants for research and development efforts of approximately \$510,000. In 2000 we did not apply for such grants. In addition, in connection with our license of technology from RND Networks in 1997, we agreed to pay royalties to the Israeli Government on sales of products based on this technology. The aggregate amount of grants received by RND Networks and us subject to this obligation were approximately \$1.1 million as of December 31, 2000. All those grants have been reimbursed as royalties to the Chief Scientist, as of February 28, 2001.

The Government of Israel does not own proprietary rights in technology developed using its funding and there is no restriction on the export of products manufactured using the technology. The technology is, however, subject to other legal restrictions, including the obligation to manufacture the product based on such technology in Israel and to obtain the Chief Scientist's consent to transfer the technology to a third party. If the Chief Scientist consents to the manufacture of the products outside Israel, we may be required to pay increased royalties, ranging from 120% to 300% of the amount of the Chief Scientist grant, depending on the percentage of foreign manufacture. These restrictions continue to apply even after we have paid the full amount of royalties payable in respect of the grants. For the years ended December 31, 1998, 1999 and 2000, we paid or accrued to the Israeli Government approximately \$152,000, \$515,000 and \$776,000. From time to time, provisions of Israeli law relating to the terms of the Chief Scientist participations have been amended and may be further amended in the future. The Israeli Government, through the Fund for the Encouragement of Marketing Activities, awards grants to Israeli companies for overseas marketing expenses, including expenses for maintaining branches, advertising, catalogs, exhibitions and surveys, up to a maximum rate of 33% of such expenses, not to exceed \$1.2 million annually. In 1998, we received grants from the marketing fund totaling approximately \$53,000, and are required to pay royalties in connection with such grants at a rate of 4% of the increase in sales outside of Israel up to the total dollar-linked amount of such grants, plus interest. Marketing grants are currently awarded only to companies whose annual exports in the year preceding the application did not exceed \$15 million.

Item 6. Directors, Senior Management and Employees**Directors and Senior Management**

The following table lists our current directors and executive officers:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Yehuda Zisapel(1)	59	Chairman of the Board of Directors
Roy Zisapel(2)	30	Chief Executive Officer, President and Director
Meir Moshe	47	Chief Financial Officer
Yiftach Weiser	43	Chief Operating Officer
Vered Raviv-Schwarz	32	General Counsel and Secretary
Sharon Trachtman	35	Vice President, Marketing
Amir Peles	29	Vice President, Chief Technology Officer
Asaf Ronen	28	Vice President, Research and Development
Yaron Danieli	44	Vice President, Sales
Yiftach Atir(3)(5)	51	Director
Avigdor Willenz(3)(5)	44	Director
Christopher McCleary(4)(5)	48	Director
Liora Katzenstein(5)	46	Nominee Director

(1) Term as director expires at the annual meeting of shareholders to be held in 2003.

(2) Term as director expires at the annual meeting of shareholders to be held in 2001.

(3) External Director, as defined in the Israeli Companies Law.

(4) Term as director expires at the annual meeting of shareholders to be held in 2002.

(5) Qualified as an Independent Director.

Yehuda Zisapel, co-founder of our company, has served as our Chairman of the Board of Directors since our inception. Mr. Zisapel also 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., RADVision Ltd. and RADCOM Ltd. Mr. Zisapel has a B.Sc. and an M.Sc. degree in electrical engineering 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.

Roy Zisapel, co-founder of our company, has served as our Chief Executive Officer and President and a director since our inception. 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.

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. From January 1992 until June 1997, Mr. Moshe was Vice President, Finance and Secretary of Formula Computers Technologies, Ltd. From January 1988 until January 1992, Mr. Moshe was Vice President, Finance of Koor Communications, Ltd., a telecommunications company. Mr. Moshe holds a B.Sc. in economics and accounting from Tel Aviv University and is a certified public accountant.

Yiftach Weiser has served as our Chief Operating Officer since March 2000. From 1994 until March 2000, Mr. Weiser was first Vice President Customer Service for Indigo Europe and then Corporate

Vice President Customer Service, General Manager Asia Pacific of Indigo N.V. From July 1993 to July 1994, Mr. Weiser was Technical Support Manager for RAD Network Devices Ltd. Mr. Weiser holds a B.Sc. degree in Computer Engineering from the Technion, Israeli Institute of Technology.

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 M. Seligman & Co. Mrs. Raviv-Schwarz has LL.B. and LL.M degrees from the Tel Aviv University.

Sharon Trachtman has served as our Vice President of Marketing since September 1997. From November 1994 to September 1997, Ms. Trachtman was a product line marketing manager for Scitex Corporation. Ms. Trachtman has a B.A. degree in computer science and philosophy from Bar Ilan University.

Amir Peles has served as our Vice President, Chief Technology Officer since April 2000. Prior to that, Mr. Peles was 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.

Assaf Ronen has served as our Vice President of Research and Development since April 2000. From February 1997 to April 2000, Mr. Ronen served as a senior program manager at Comverse Network Systems. Prior to February 1997, Mr. Ronen served in various positions in the Israel Defense Forces Computers Unit. Mr. Ronen has a B.Sc. degree in computer science from the Israeli Open University and an M.B.A. from Manchester University.

Yaron Danieli has served as our Vice President, Sales since 1999. From 1997 through 1999 Mr. Danieli served as our sales director for Asia-Pacific. From 1994 through 1997 Mr. Danieli served as International Marketing Manager at Electrode Works Zika Ltd. From 1991 through 1993 Mr. Danieli served as Chief Financial Officer at Asiv Textile Industries Ltd. Mr. Danieli has a B.Sc. degree in Management Systems Engineering from the Technion, Israel Institute of Technology.

Yiftach Atir has served as a director since November 1997. As of August 2000 Mr. Atir serves as the managing director of Koor Corporation Venture Capital. Until July 2000 Mr. Atir served as a managing director in Evergreen Canada-Israel Management Ltd., a management company for a group of technology focused venture capital funds, where he had been employed since November 1994. Prior to joining Evergreen, Mr. Atir served as a Brigadier General in the Intelligence Corps of the Israel Defense Forces, where he had overall responsibility for screening new technologies, which included managing many multi-disciplined high-tech projects. Mr. Atir has a B.A. in political science from Haifa University and an M.B.A. from Tel Aviv University.

Avigdor Willenz has served as a director since October 1999. Since November 1992, Mr. Willenz has served as Chief Executive Officer and Chairman of the Board of Directors of Galileo Technology Ltd. Mr. Willenz holds a B.S.E.E. from the Technion, Israel Institute of Technology.

Christopher McCleary has served as a director since February 2000. Mr. McCleary is a co-founder of USinternetworking Inc. and has served as the Chairman and Chief Executive Officer of USi since January 1998. Prior to founding USi, he was the Chairman and Chief Executive Officer of DIGEX, Inc. from January 1996 to December 1997. Prior to serving at DIGEX, Mr. McCleary served as Vice President and General Manager for Satellite Telephone Service at American Mobile Satellite Corporation, a satellite communications company, from October 1990 to January 1996. Mr. McCleary has a B.S. from the University of Kentucky.

Liora Katzenstein has served as a director since January 2001. In 1996 Mrs. Katzenstein founded and has since served as President and CEO of ISEMI — Israel School of Entrepreneurial Management and Innovation (Member of Swinburne University of Technology's (Australia) Centre of Enterprise Innovation Worldwide Network). Mrs. Katzenstein is also a Senior Lecturer in Business Administration at the Technion, Israel Institute of Technology and a program manager in the Israeli Management Center. From 1995 to 1996 Mrs. 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. Mrs. Katzenstein has a Lisence 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.

Nasdaq National Market

Our ordinary shares are listed for quotation on the Nasdaq National Market and we are subject to the rules of the Nasdaq National Market applicable to listed companies. Under the Nasdaq rules companies quoted on Nasdaq are required to have at least three independent directors, maintain an audit committee, all of whose members are independent, and adopt an audit committee charter. The responsibilities of the audit committee under the new Nasdaq rules include, among other things, evaluating the independence of a company's outside auditors. Chris McCleary, Yiftach Atir, Avigdor Willenz and Liora Katzenstein qualify as independent directors under the Nasdaq National Market requirements, and are all members of the Audit Committee.

Israeli Companies Law

We are subject to the provisions of the new Israeli Companies Law, 5759-1999, which became effective on February 1, 2000 and regulations adopted thereunder.

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 two external directors. 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; or
- 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.

The Companies Law defines the term "office holder" of a company to include a director, the chief executive officer, the chief financial officer 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, conflict of interests 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, 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:

- the majority of shares voted at the meeting, including at least one third of the shares of non-controlling shareholders voted at the meeting, vote 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 an additional three years. External Directors may be removed from office only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors 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. In the general shareholders meeting held on June 22, 2000 Messrs. Yiftach Atir and Avigdor Vilenz were elected as External Directors.

Audit Committee

Nasdaq Requirements

As described above, under the Nasdaq rules, we are required, by June 2001, 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 member of our Audit Committee meet the above requirements. The responsibilities of the audit committee under the Nasdaq rules include evaluating the independence of a company's outside auditors. In addition, we were required to adopt an audit committee charter by June 2000, and such a charter was adopted.

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; and
- 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.

The role of the audit committee is to examine flaws in the business management of the company, in consultation with the internal auditor and the company's independent accountants, suggest appropriate course of action and to approve specified related party transactions. Our Audit committee consists of our external directors, and two additional directors, Mr. Christopher McCleary and Prof. Liora Katzenstein.

Approval Of Interested Party Transactions

The approval of the audit committee is required 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 related 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.

Internal Auditor

Under the Companies Law, the board of directors must appoint an internal auditor proposed by the audit committee. The role of the internal auditor is to examine, inter alia, whether the company's actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor 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. 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. We have appointed Mr. Gideon Duvshani, CPA, as an 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 on the advisability of a given action brought for his approval or performed by him by virtue of his 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 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 a company’s affairs which the office holder has received due to his position as an office holder.

Disclosure of Personal Interest of an Office Holder

The Israeli 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 must also disclose any personal interest held by:

- the office holder’s spouse, siblings, parents, grandparents, descendants, spouse’s descendants and the spouses of any of these people; or
- any corporation in which the office holder is a 5% or greater shareholder, director or general manager or in which he has the right to appoint at least one director or the general manager.

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

- other than in the ordinary course of business;
- otherwise than on market terms; or
- that is likely to have a material impact of 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. A transaction that is adverse to the company’s interest may not be approved.

If the transaction is an extraordinary transaction, approval of both the audit committee and the board of directors is required. 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.

Disclosure of Personal Interests of a Controlling Shareholder

Under the Israeli 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 rights if no other shareholder owns more than 50% of the voting rights, 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 with a controlling shareholder or in which a controlling shareholder has a personal interest, and the 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 vote on the matter 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 rights in the company.

Shareholders generally have the right to examine any document in the company's possession pertaining to any matter that requires shareholder approval. If this information is made public in Israel or elsewhere, we will file the information with the Securities and Exchange Commission in the United States.

Staggered Board

Our articles of association provide for a board of directors of not less than five and not more than nine directors. In accordance with the terms of our articles of association, our board of directors is divided into three classes with each class serving until the third annual meeting following their election as follows:

<u>Class</u>	<u>Term expiring at the annual meeting for the year</u>	<u>Directors</u>
Class I	2003	Yehuda Zisapel and Zohar Zisapel*
Class II**	2001	Roy Zisapel
Class III	2002	Christopher McCleary

* Zohar Zisapel resigned as of April 30, 2001.

** Prof. Liora Katzenstein will be added to Class II at the next shareholders meeting.

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 Messrs. Avigdor Vilenz and Yiftach Atir, who were appointed as external directors whose term of appointment is three years, and may be extended for an additional period of three years, in accordance with the Companies Law.

Our Committees

Our board of directors has formed an audit committee and a share incentive committee. The audit committee, which consists of Messrs. Yiftach Atir and Avigdor Willenz, our External Directors, as well as Mr. Christopher McCleary and Prof. Liora Katzenstein, examines flaws in the business management of the company, suggests appropriate course of action and approves specified related party transactions. Our share incentive committee, which consists of Messrs. Yehuda Zisapel and Roy Zisapel, administers our share option plan.

Members of our board of directors do not have service contracts with us and are not entitled to receive any benefits upon termination of their term as director.

Voting Agreement

Yehuda Zisapel, Zohar Zisapel and Roy Zisapel were parties to a voting agreement, which terminated on March 2001. The agreement provided that, in respect of the election of our directors, they would nominate and vote for all three of them as directors. Under the voting agreement, no party was permitted to vote for the election of any other person as a director unless all these shareholders agree.

Founders' Agreement

On April 1, 1997, we entered into an agreement with our founders, Messrs. Zohar, Yehuda and Roy Zisapel, pursuant to which Roy Zisapel agreed to serve as our chief executive officer for a period of no less than five years. In consideration for his services:

- we agreed to pay Roy Zisapel an annual salary of approximately \$44,000, plus benefits, including contributions to a managers' insurance policy*; and
- we granted Roy Zisapel options under our share option plan equal to 9.9% of the total amount of our issued and outstanding share capital as of April 1997.

In addition, the agreement provides that Roy Zisapel may not compete with us or disclose to third parties information pertaining to our business for a period ranging from twelve to thirty months from the date of termination of his employment, depending on the length of his term of employment with us.

* Mr. Zisapel's salary was increased and approved by the general meeting held on June 22, 2000.

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 require the approval of the audit committee, the board of directors and then the approval of the shareholders of the company. An external director is entitled to consideration and reimbursement of expenses only as provided in regulations promulgated under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with his service as an external director.

To date, none of the directors, including the external directors, receive compensation for attending the board, other than options, as detailed herein.

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, 2000. 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.

	<u>Salaries, fees, commissions and bonuses</u>	<u>Pension, retirement and other similar benefits</u>
All directors and officers as a group, consisting of 14 persons	\$935,000	\$60,000

As of March 31, 2001, our directors and officers as a group, consisting of 14 persons, held options to purchase an aggregate of 1,053,455 ordinary shares. Other than reimbursement for expenses and grant of options to purchase shares of the Company, we do not compensate our directors for serving on our board of directors.

During 2000, we granted in the aggregate to our directors and officers options to purchase 214,969 ordinary shares at a weighted average exercise price of \$21.98. The options expire sixty-two months after grant.

Key Employee Share Incentive Plan

In June 1997, we adopted our Key Employee Share Incentive Plan (1997). 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, 2000, 3,314,400 ordinary shares have been reserved for option grants under the plan, of which we have granted options to purchase 2,795,519 ordinary shares, including 1,020,573 to Roy Zisapel, our Chief Executive Officer and President, at a weighted average exercise price of \$9.68 per ordinary share. We intend to grant further options under our share option plan to our executive officers and employees.

Our share option plan is administered by the share incentive committee of our board of directors. Pursuant to the plan, the committee has the authority to determine, 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 selected by the share incentive committee. The trustee will not release the options or ordinary shares to the option holder before the later of (1) the second anniversary of the registration of the options in the name of the trustee on behalf of the option holder and (2) the initial public offering of our ordinary shares. During this period, voting rights on the ordinary shares issued in respect of these options are vested in Messrs. Zohar and Yehuda Zisapel.

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.

1999 Employee Stock Purchase Plan

We adopted an employee stock purchase plan effective as of May 1, 2000. The purpose of the employee stock purchase plan is to align employee and shareholder long-term interests by facilitating the purchase of our ordinary shares by employees and to enable employees to develop and maintain significant ownership of ordinary shares. The Stock Purchase Plan applies only to employees of our US subsidiary, Radware Inc.

General. The employee stock purchase plan is intended to comply with the requirements of Section 423 of the Internal Revenue Code, and to assure the participants of the tax advantages provided thereby. The number of our ordinary shares available for issuance under the employee stock purchase plan is limited to 200,000 ordinary shares.

Administration. The employee stock purchase plan is be administered by a committee established by the board of directors. The committee may make such rules and regulations and establish such procedures for the administration of the employee stock purchase plan as it deems appropriate.

Eligibility. All employees of the company and its designated subsidiaries who have at least one year of service and work more than 20 hours per week and five months in a calendar year will be eligible to participate

in the employee stock purchase plan, except that employees who are “highly compensated” within the meaning of Section 414(q) of the Code and employees who are five percent or more stockholders of the company or any parent or subsidiary of the company are not eligible to participate.

Grants. Pursuant to the employee stock purchase plan, each eligible employee will be permitted to purchase ordinary shares up to two times per calendar year through regular payroll deductions in an aggregate amount equal to 1% to 10% of the employee’s base pay, as elected by the employee, for each payroll period. Under the employee stock purchase plan, a participant’s right to purchase ordinary shares may not accrue at a rate that exceeds \$25,000 of fair market value of the ordinary shares during any calendar year.

Offering Period; Purchase Period. The initial offering period commenced on November 15, 2000 and will end on the last trading day on or prior to the second anniversary of the commencement date. Each subsequent offering period will have a duration of approximately one year, commencing on the first trading day and ending on the last trading day of each calendar year (commencing with calendar year 2001). Each purchase period will have a duration of approximately six months.

Exercise Price. As of the last day of each purchase period ending within an offering period, participating employees will be able to purchase ordinary shares with payroll deductions for a purchase price equal to the lesser of:

- 85% of the fair market value of the ordinary shares on the date the offering period begins; and
- 85% of the fair market value of the ordinary shares on the last day of the purchase period.

A right to purchase shares which is granted to a participant under the employee stock purchase plan is not transferable otherwise than by will or the laws of descent and distribution.

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, 2000, we had 223 employees worldwide, of whom 109 were based in Israel 88 were based in the United States, and 26 were based in our other subsidiaries and offices. Of these 223 employees, 51 were employed in research and development, 134 were employed in sales and marketing, and 38 were employed in management, operations and administration.

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. To date, we have not experienced any work stoppages.

The employees of our subsidiaries are subject to local labor laws, regulations and/or collective bargaining agreements that vary from country to country.

Share Ownership

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and officers as of March 31, 2001. The percentage of outstanding ordinary shares is based on 16,363,134 ordinary shares outstanding as of March 31, 2001.

<u>Name</u>	<u>Number of ordinary shares</u>	<u>Percentage of outstanding ordinary shares</u>	<u>Number of options</u>
Yehuda Zisapel	3,411,227	20.85%	—
Zohar Zisapel(1)	940,381	5.76%	—
Roy Zisapel(2)	807,173	4.93%	113,400
All directors and executive officers as a group (14 persons)(3)(4)	5,299,687	32.39%	407,376

(1) Mr. Zohar Zisapel resigned from the board as of April 30, 2001.

(2) Consists of 300,000 shares and 507,173 options exercisable as of March 31, 2000. an additional 113,400 options vest in one-third increments on each of January 1, 2002, 2003 and 2004. The options have a weighted average exercise price of \$0.64 and terminate sixty-two months after the grant date if not sooner exercised.

(3) Consists of 5,160,781 shares and 646,079 options which are fully vested or which will be fully vested within the next 60 days.

(4) 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 have therefore not been separately disclosed.

Item 7. Major Shareholders and Related Party Transactions**Major Shareholders**

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of April 2000, 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 (based on 13-G filings for December 31, 2000).

<u>Name</u>	<u>Number of ordinary shares</u>	<u>Percentage of outstanding ordinary shares</u>
Yehuda Zisapel(1)	3,411,227	20.85%
Morgan Stanley Dean Witter(2)	2,759,592	16.9%
Provident Investment Counsel, Inc.	831,250	5.7%
Zohar Zisapel(3)	940,381	5.76%

(1) Includes 920,000 ordinary shares owned of record by Carm-AD Ltd.

(2) Includes 1,388,746 ordinary shares owned by Morgan Stanley Dean Witter & Co. and 1,370,846 ordinary shares owned by Morgan Stanley Dean Witter Investment Management Inc.

(3) Includes 448,200 ordinary shares owned of record by Lomsha Ltd. and 448,200 ordinary shares owned of record by Michael and Klil Holdings (93), Ltd.

Related Party Transactions*Services Furnished by RAD Data Communications Ltd. and BYNET Data Communications Ltd.*

Each of RAD Data Communications Ltd. and BYNET Data Communications Ltd., our affiliates and members of the RAD-BYNET group, provides us with personnel and administrative services (and until July 2000 with legal services), and we reimburse each for its costs in providing such services. The aggregate amount of these reimbursements was approximately \$103,000 in 2000.

Technology Transfer Agreement

In November 1997, we entered into a technology transfer agreement with RND Networks Ltd., our affiliate and a member of the RAD-BYNET group, pursuant to which we obtained a perpetual, non-exclusive, royalty-free license for technology that was developed by RND Networks Ltd. and that is used in our products, for a one-time payment of \$250,000. The technology relates to a standard component used as the basic platform for our products. As a condition for the approval of the Chief Scientist of the Ministry of Industry and Trade required for the license of the technology, we have committed to pay royalties to the Government of Israel on proceeds from sales of products which incorporate this technology. The obligations totaled to approximately \$1.0 million, and were reimbursed fully to the Chief Scientist as of February 28, 2001.

Components Purchase Agreements

In July 1999, we entered into a turnkey operating services agreement with RAD Operation Services Ltd., our affiliate and a member of the RAD-BYNET group, pursuant to which RAD Operation Services Ltd. agreed to supply us with circuit boards, the principal component used in the manufacture of our products, at agreed upon prices. In addition, RAD Operation Services Ltd. agreed to provide us with operational management services, including mechanical development, management information systems and procurement. In consideration for these services, we pay RAD Operation Services Ltd. a monthly fee of approximately \$7,000.

Lease of Property in Jerusalem

We sublease from RAD Operation Services Ltd. approximately 2,150 square feet for our facility in Jerusalem, for a monthly rent of \$1,960. The term of the sublease is five years, commencing May 1, 1999 and terminating in March 2004, with an option to renew for an additional five year term. We entered into an additional oral sublease agreement in Jerusalem with RAD Operation Services Ltd. for approximately 3,229 square feet, for a monthly rent of approximately \$4,000. The term of the lease shall be 3 years. The parties intend to enter into a written lease agreement with respect to the aforesaid sublease.

Asset Purchase Agreement

In January 1999, our subsidiary, Radware Inc., agreed to acquire all of the assets of RND Networks, Inc., our affiliate and a member of the RAD-BYNET group, for an aggregate purchase price of approximately \$171,000. In addition, we agreed to pay RND Networks, Inc. an additional amount equal to approximately \$153,000 in consideration for recruiting services rendered in the United States.

We believe that the terms of the transactions in which we have engaged and are currently engaged with other members of the RAD-BYNET group are beneficial to us and no less favorable to us than terms which might be available to us from unaffiliated third parties. All future transactions and arrangements with other members of the RAD-BYNET group in which our office holders and directors have a personal interest will require approval by the audit committee and our board of directors and may also require approval by our shareholders.

Lease Agreement for the Company's Headquarters

As of December 1, 2000, we lease the office space for our headquarters and principal 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 23,345 square feet. The monthly rent amounts to approximately \$39,000. The lease expires in October 2005, and we have an option to extend the lease for an additional period of five years. We also lease additional 9,485 square feet in the building under the same lease agreement, which are subleased to affiliated companies back-to-back.

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 an oral agreement with Bynet 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. We intend to enter into a written non-exclusive distribution agreement with Bynet Data Communications Ltd.

Registration Rights

In connection with the private placement of our Series B preferred shares, most of our existing shareholders prior to our initial public offering were granted registration rights with respect to the ordinary shares outstanding or to be issued upon conversion of their preferred shares (8,581,336 ordinary shares in the aggregate). The agreements provide that each of Messrs. Yehuda and Zohar Zisapel, as a group, the Evergreen Group and the Polaris Group, as a group, and HarbourVest together with all of the other investors in the June 1999 private placement, as a group, will have the right to make a single demand for the registration of their ordinary shares outstanding at the time of our initial public offering, provided that the demand covers shares representing a market value of at least \$3 million. The shareholders' rights will be exercisable at any time commencing on the first anniversary of the consummation of our initial public offering and for a period of three years or, in specified cases, for a period of five years thereafter. In addition, each of the shareholders has the right to have its ordinary shares included in certain of our registration statements.

Voting Agreement

See discussion on page 51, under “Directors and Senior Management”.

Founders’ Agreement

See discussion on page 52, under “Directors and Senior Management”.

Item 8. Financial Information

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

Item 9. The Listing**Markets**

Our ordinary shares have been listed for quotation on the Nasdaq National Market as of September 30, 1999, under the symbol “RDWR”. Prior to that date, there had been no market to our ordinary shares.

Listing Details

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

	Price per share	
	High	Low
1999		
October 1 – December 31	80.0	26.5
2000		
January 1 – December 31	67.4375	14.9375
January 1 – March 31	67.4375	38.75
April 1 – June 30	33.25	15.25
July 1 – September 30	40.0	24.875
October 1 – December 31	29.3125	14.9375
2001		
January 1 – March 31	21.9375	10.1875
April 1 – May 14	9.875	18.64

Item 10. Additional information**Memorandum and Articles of Association****Objects and Purposes**

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. 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.

Transfer of Shares and Notices

Fully paid ordinary shares may be freely transferred pursuant to our articles of association unless such transfer is restricted or prohibited by another instrument. Unless otherwise prescribed by law, each shareholder of record will be provided at least 21 calendar days' prior notice of any general shareholders meeting.

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 fiscal year or as accrued over a period of two years, whichever is higher. Our shareholders are authorized to declare dividends, after they have received a recommendation of our board, in an amount not to exceed the board's recommendation, and provided further that there is no reasonable concern that the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. 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

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders.

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 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.

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 actions and transactions which require shareholder approval.

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

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 called on at least 21 days' prior notice. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares held by parties other than the other party to the merger, or by any person who holds 25% or more of the shares 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 70 days have passed from the time that a proposal of the merger has been filed with the Israeli Registrar of Companies.

The Companies Law also provides that an acquisition of shares of public company must be made by means of tender offer if as a result of the acquisition the purchaser would become a 25% shareholder of the company and there is no 25% or more shareholder in the company. If there is no 50% or more shareholder in the company, the Companies Law provides that an acquisition of shares of 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% shareholder of the company. This rule does not apply if someone else is already a majority shareholder in the company. If following any acquisition of shares, the acquirer will hold 90% or more of the company's shares, the acquisition may not be made other than through a tender offer to acquire all of the shares of such class. If more than 95% of the outstanding shares are tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to it. However, the remaining minority shareholders may seek to alter the consideration by court order.

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.

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. 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.

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 duty of loyalty, but may exempt in advance an office holder from his liability to the company, in whole or in part, for a breach of his duty of care, provided that the articles of association of the company allow it to do so. We intend to amend our articles of association to 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 duty of care to us or to another person;
- a breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice our interests; or
- a financial liability imposed upon him in favor of another person.

We have obtained directors and officers liability insurance for the benefit of our office holders.

Indemnification of Office Holders

Our articles of association provide that, subject to the provisions of 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 obligation imposed on him in favor of another person by a court judgment, including a compromise judgment or an arbitrator's award approved by the court; and
- reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him by a court in connection with proceedings we institute against him or instituted on our behalf or by another person, a criminal charge from which he was acquitted or a criminal proceeding in which he was convicted of an offense that does not require proof of criminal intent.

We intend to amend our articles of association to authorize us to:

- undertake to indemnify an office holder as described above, provided that the undertaking is limited to types of events which our board of directors deems to be anticipated when the undertaking is given and to an amount determined by our board of directors to be reasonable under the circumstances; and

- to retroactively indemnify an officer or director.

Limitations on Exculpation, Insurance and Indemnification

The Companies Law provides that a company may not exculpate or 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 duty of loyalty unless, with respect to 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 duty of care if the breach was done intentionally or recklessly;
- 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.

Material Contracts

For a summary of our material contracts, see “Item 7 — Related Party Transactions.”

Taxation

Israeli Tax Considerations and Foreign Exchange Regulation

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli and United States 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 tax authorities in question. 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.

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.

General Corporate Tax Structure

Israeli companies are subject to “Company Tax” at the rate of 36% of taxable income. 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 for the Encouragement of Capital Investments, 1959, as amended (the “**Investment Law**”), provides 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 bases its decision as to whether or not to approve an application on the criteria set forth in the Investment 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 Investment Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. 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 Investment Law are not 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 Investment 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 Investment 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 company tax at the maximum rate of 25%, rather than 36%, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income, and is limited to twelve years from commencement of production or 14 years from the date of approval, whichever is earlier.

Instead of the foregoing tax benefits, a company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company's undistributed income derived from an approved enterprise will be exempt from company 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.

A company that has elected the alternative package of benefits and that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to tax in respect of the 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 taxed at the reduced 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, regardless of whether the dividend is converted into foreign currency.

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 Investment 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.

In December 1998, the Investment Center granted us an approval for establishing an "approved enterprise" program at our manufacturing facility under the Investment Law. Although we do not currently have an approved enterprise program, we have made the necessary capital investments to establish an approved enterprise program.

We have elected the alternative package of benefits for the approved enterprise program we intend to establish at our manufacturing facility. Once it is established, our income derived from this approved enterprise program will be tax exempt for a period of two years and will be subject to a reduced company tax of up to 25% for the following five years. A bill submitted to the Israeli Parliament by the Israeli Government on July 26, 2000, proposes, among other things, to increase the tax rate from zero to 10% during the exempted period under the alternative package of benefits — see below — *"Proposed Reform of Taxes on Income in Israel"*.

The approval which the Investment Center granted us is for establishing an approved enterprise program in Tel Aviv, Israel. However, our manufacturing facility and a part of our research and development is located in Jerusalem and we, therefore, have submitted a request to the Investment Center to designate our approved

enterprise program for tax benefits applicable to an enterprise established and located in Jerusalem, and a request for an extension to continue the capital investments in our facilities in Jerusalem during 2001. These benefits provide that income derived from the approved enterprise program will be tax exempt for six years and will be taxed at a reduced company tax rate of up to 25% for one additional year. The six-year tax exemption period may be extended to ten years with no additional year of reduced tax rate, if we apply to the Investment Center for recognition as a "High Technology" facility and this status is recognized. There is no assurance our above requests will be accepted by the Investment Center. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

Grants under the Law for the Encouragement of Industrial Research and Development, 1984

Under the Law for the Encouragement of Industrial Research and Development, 1984 (the "**Research Law**"), research and development programs which meet specified criteria and are approved by a governmental committee of the Office of the Chief Scientist are eligible for grants of up to 50% of the project's expenditure, as determined by the research committee, in exchange for the payment of royalties from the sale of products developed in accordance with the program. Regulations promulgated under the Research Law generally provide for the payment of royalties to the Israeli Government ranging from 3% to 5% on sales of products developed using such grants until 100% of the dollar-linked grant is repaid.

The Research Law requires that products developed with Chief Scientist grants be manufactured in Israel. However, under the regulations promulgated under the Research Law, products developed with Chief Scientist grants may be manufactured outside of Israel by any entity other than the company which received the grants, with the approval of the Chief Scientist, except that the company would be required to pay royalties that are adjusted in proportion to manufacturing outside of Israel, effectively adjusting the royalties to a percentage equal to the ratio of the amount of grants received from the Chief Scientist, linked to the dollar, divided by the amount of grants received from the Chief Scientist, linked to the dollar, and the investments made by the company in the project. In addition, the total amount to be repaid to the Israeli Government will also be adjusted to 120%, 150% or 300% of the grant if the manufacturing volume that is performed outside Israel is less than 50%, between 50% and 90% or more than 90% of the company's total manufacturing volume. The technology developed pursuant to the Chief Scientist grants may not be transferred to third parties without the prior approval of a governmental committee under the Research Law. Such approval, however, is not required for the export of any products developed using the grants. Approval of the transfer of technology may be granted only if the recipient abides by the provisions of the Research Law and regulations promulgated thereunder, including the restrictions on the transfer of know-how and the obligation to pay royalties.

Effective for grants received from the Chief Scientist under programs approved after January 1, 1999, the outstanding balance of such grants to be repaid through the payment of royalties will be subject to interest at a rate equal to LIBOR for 12 months applicable to dollar deposits.

The funds generally available for Chief Scientist grants were reduced in 1998 and remained at the same level in 1999, and the Israeli authorities have indicated that the government may further reduce or abolish Chief Scientist grants in the future.

Generally, expenditures supported under other incentive programs of the State of Israel are not eligible for Chief Scientist grants.

Tax Benefits and Grants 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. Expenditures not so approved are deductible over a three-year period. However, expenditures made out of proceeds made available through government grants are not deductible.

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:

- 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; and
- accelerated depreciation rates on equipment and buildings.

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 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

The Income Tax Law (Inflationary Adjustments), 1985, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features which are material to us can be described as follows:

- The law provides for a special tax adjustment for the preservation of equity whereby certain corporate assets are classified broadly into fixed assets and non-fixed assets. Where a company’s equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company’s equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.
- Subject to certain limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.
- Taxable gains on certain traded securities which are normally exempt from tax are taxable in specified circumstances. However, dealers in securities are subject to the regular tax rules applicable to business income in Israel.

Capital Gains Tax on Sales of Our Ordinary Shares

Israeli law imposes a capital gains tax on the sale of capital assets. 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 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. The inflationary surplus accumulated from and after December 31, 1993, is exempt from any capital gains tax in Israel while the real gain is added to ordinary income, which is taxed at ordinary rates of 30% to 50% for individuals and 36% for corporations.

Under current law, sales of our ordinary shares are exempt from Israeli capital gains for so long as they are quoted on Nasdaq or listed on a stock exchange in a country appearing in a list approved by the Controller of Foreign Currency and we qualify as an Industrial Company. There can be no assurance that we will maintain such qualification or our status as an Industrial Company. We also cannot assure that Israeli law will not be changed, as currently proposed, to apply Israeli capital gains tax on the sale of our ordinary shares.

Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income.

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 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 unless 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. In this 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 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, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares, or stock dividends, income tax at the rate of up to 25% is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. 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, under the Investment Law, dividends generated by an Approved Enterprise are taxed at the rate of 15%. Furthermore, dividends not generated by an Approved Enterprise paid to a U.S. company holding 10% or more of our ordinary shares are taxed at a rate of 12.5%.

Under an amendment to the Inflationary Adjustments Law, non-Israeli corporations might be subject to Israeli taxes on the sale of traded securities in an Israeli company, subject to the provisions of any applicable double taxation 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 "— Capital Gains Tax on Sales of Our Ordinary Shares."

Foreign Exchange Regulations

Dividends (if any) paid to the holders of our ordinary shares, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion.

Proposed Reform of Taxes on Income in Israel

On July 26, 2000, the Israeli government submitted tax reform legislation (hereinafter the "Bill") to the Israeli Parliament. The Bill is based on the recommendations of the Public Committee on the Reform of Taxes on Income, to broaden the categories of taxable income, and to reduce the tax rates imposed on employment income.

The Bill includes, among other things, to impose a tax upon capital gains at a rate of up to 25% for individuals, including capital gains derived from the sale of shares in publicly traded companies (which are currently exempt from capital gains tax); to impose a tax upon all income of Israeli residents (individuals and corporations) regardless of the territorial source of income; and to increase the tax rate from zero to 10% on the exempt period under the alternative package of benefits for approved enterprises under the Law for the Encouragement of Capital Investments, 1959.

In order to be enacted as legislation the Bill must be approved by the Israeli parliament and published. If implemented, the Bill might result in the imposition of Israeli capital gains taxes on non-Israeli residents, who are not eligible for an exemption under a relevant tax treaty:

- imposing a tax upon capital gains at a rate of up to 25% for individuals, including capital gains derived from the sale of shares in those publicly traded companies which are currently exempt from capital gains tax;
- imposing a tax upon all income of Israeli residents (individuals and corporations) regardless of the territorial source of income; and
- increasing the tax rate from zero to 10% on the exempt period under the alternative package of benefits for approved enterprises under the Law for the Encouragement of Capital Investments, 1959.

United States Federal Income Tax Considerations

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

- a citizen or resident of the United States;
- a corporation or other entity taxable as a corporation created or organized in the United States or under the laws of the United States or of any political subdivision thereof;
- an estate, the income of which is subject to United States federal income tax purposes regardless of its source; or
- in general, a trust, if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

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 ordinary shares.

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 shareholder based on such shareholder’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:

- taxpayers who are broker-dealers or insurance companies;
- taxpayers who have elected mark-to-market accounting;
- tax-exempt organizations or retirement plans;
- financial institutions or “financial services entities”;
- taxpayers who hold ordinary shares as part of a straddle, “hedge” or “conversion transaction” with other investments;
- non-U.S. Holders;
- Holders who acquired their shares upon the exercise of employee stock options or otherwise as compensation;
- persons who hold their shares through partnerships or other pass-through entities;

- holders owning directly, indirectly or by attribution at least 10% of our voting power; and
- taxpayers whose functional currency 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 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 their particular circumstances.

Taxation of Ordinary Shares

Taxation of Dividends Paid On Ordinary Shares. A U.S. Holder will be required to include in gross income as ordinary income the amount of any distribution paid on 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 the ordinary shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of ordinary shares.

Distributions of current or accumulated earnings and profits paid in foreign currency to a U.S. Holder 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. A U.S. Holder that receives a foreign currency distribution and converts the foreign currency into U.S. dollars subsequent to 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 shareholder. 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 dividends received on the ordinary shares to the extent 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 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 16 day holding period required by the statute. In addition, distributions of current or accumulated earnings and profits will be foreign source passive income for United States foreign tax credit purposes and will not qualify for the dividends received deduction available to corporations.

Taxation of the Disposition of Ordinary Shares. Upon the sale, exchange or other disposition of 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 the 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 date 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 ordinary shares held more than one year is long-term capital gain, and is eligible for a maximum 20% rate of taxation for individuals. Gains recognized by a U.S. Holder on a sale, exchange or other disposition of 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 ordinary shares is allocated to U.S. source income. The deductibility of a capital loss recognized on the sale, exchange or other disposition of ordinary shares is subject to limitations. A U.S. Holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into U.S. dollars subsequent to the settlement date or trade date (whichever date the taxpayer was required to use to calculate the value of the proceeds of sale) 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.

Anti-Deferral Regimes. Notwithstanding the above rules regarding distributions and dispositions, special rules may apply to some U.S. Holders (or to the direct or indirect beneficial owners of some non-U.S. Holders) if one or more anti-deferral regimes discussed below are applicable. The rules regarding each of these regimes are complex, and holders should consult their tax advisers with respect to the applicability and impact of these regimes to their ownership of our shares.

Foreign Personal Holding Company Status. If at any time during a taxable year more than 50% of the total combined voting power or the total value of our outstanding shares is owned, actually or constructively, by five or fewer individuals who are citizens or residents of the United States and 60% or more of our gross income for such year was derived from certain passive sources (e.g., from dividends received from its subsidiaries), we would be treated as a “foreign personal holding company.” In that event, U.S. Holders that hold ordinary would be required to include in income for such year their allocable portion of our passive income which would have been treated as a dividend had that passive income actually been distributed.

Controlled Foreign Corporation Status. If more than 50% of the voting power of all classes of stock or the total value of the stock of our company is owned, directly or indirectly, by U.S. Holders, each of whom own after applying rules of attribution 10% or more of the total combined voting power of all classes of stock of our company, we would be treated as a “controlled foreign corporation” or “CFC” under Subpart F of the Code. This classification would bring into effect many complex results including the required inclusion by such 10% U.S. Holders in income of their pro rata share of “Subpart F income” (as defined by the Code) of our company and our earnings invested in “U.S. property” (as defined by Section 956 of the Code). In addition, under Section 1248 of the Code if we are considered a CFC at any time during the five year period ending with the sale or exchange of its stock, gain from the sale or exchange of ordinary shares of our company by such a 10% U.S. Holder of our ordinary shares at any time during the five year period ending with the sale or exchange is treated as ordinary dividend income to the extent of our earnings and profits attributable to the stock sold or exchanged. Because of the complexity of Subpart F, and because we may never be a CFC, a more detailed review of these rules is beyond of the scope of this discussion.

Passive Foreign Investment Company Status. We will be a passive foreign investment company, or PFIC, if 75% or more of our gross income in a taxable year, including our pro rata share of the gross income of any company, U.S. or foreign, in which we are considered to own 25% or more of the shares by value, is passive income. Alternatively, we will be considered to be a PFIC if at least 50% of our assets in a taxable year, averaged over the year and ordinarily determined based on fair market value and including our pro rata share of the assets of any company in which we are considered to own 25% or more of the shares by value, are held for the production of, or produce, passive income. Passive income includes amounts derived by reason of the temporary investment of funds raised in our initial public offering and this offering. If we were a PFIC, and a U.S. Holder did not make an election to treat us as a “qualified electing fund” (as described below):

- Excess distributions by us to a U.S. Holder would be taxed in a special way. “Excess distributions” are amounts received by a U.S. Holder with respect to our stock in any taxable year that exceed 125% of the average distributions received by such U.S. Holder from us in the shorter of either the three previous years or such U.S. Holder’s holding period for ordinary shares before the present taxable year. Excess distributions must be allocated ratably to each day that a U.S. Holder has held our stock. A

U.S. Holder must include amounts allocated to the current taxable year in its gross income as ordinary income for that year. A U.S. Holder must pay tax on amounts allocated to each prior taxable year and the taxable years prior to our status as a PFIC in which we were a PFIC at the highest rate in effect for that year on ordinary income and the tax is subject to an interest charge at the rate applicable to deficiencies for income tax.

- The entire amount of gain that realized by a U.S. Holder upon the sale or other disposition of our ordinary shares will also be treated as an excess distribution and will be subject to tax as described above.
- The tax basis in shares of our stock that were acquired from a decedent who was a U.S. Holder would not receive a step-up to fair market value as of the date of the decedent's death but would instead be equal to the decedent's basis, if lower.

The special PFIC rules described above will not apply to a U.S. Holder if the U.S. Holder makes an election to treat us as a "qualified electing fund" for the first taxable year in which the U.S. Holder owns ordinary shares or in which we are a PFIC, whichever is later, and if we comply with certain reporting requirements. Instead, a shareholder of a qualified electing fund is required for each taxable year in which we are a PFIC to include in income a pro rata share of the ordinary earnings of the qualified electing fund as ordinary income and a pro rata share of the net capital gain of the qualified electing fund as long-term capital gain, subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. We have agreed to supply U.S. Holders with the information needed to report income and gain pursuant to a QEF election in the event we are classified as PFIC. The QEF election is made on a shareholder-by-shareholder basis. Once made, the election applies to all subsequent taxable years of the U.S. Holder in which it holds our ordinary shares and for which we are a PFIC and can be revoked only with the consent of the Internal Revenue Service (the "IRS"). A shareholder makes a QEF election by attaching a completed IRS Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return and by filing such form with the IRS Service Center in Philadelphia, Pennsylvania. Even if a QEF election is not made, a U.S. person who is a shareholder in a PFIC must file a completed IRS Form 8621 every year.

A U.S. Holder of PFIC stock which is publicly traded could elect to mark the stock 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 the PFIC stock and the U.S. Holder's adjusted tax basis in the PFIC stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. If the mark-to-market election were made, then the rules set forth above would not apply for periods covered by the election.

We were not a PFIC for 2000 or for any prior taxable year. However, 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 2001 or at a later stage. U.S. Holders who hold 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.

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 elections 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 does not qualify for an exemption; 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. Under the Code, a U.S. Holder may be subject, under certain circumstances, to backup withholding at a 31% rate with respect to dividends paid on our ordinary shares unless the holder provides proof of an applicable exemption or correct taxpayer identification number (“TIN”) and otherwise complies with applicable requirements of the backup withholding rules.

A holder of ordinary shares who does not provide a correct TIN 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.

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 450 Fifth Street, N.W., 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.

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 United States companies whose securities are registered under the Exchange Act. However, we intend to file with the Securities and Exchange Commission, within 180 days after the end of each fiscal year, an annual report on Form 20-F containing financial statements which will be examined and reported on, with an opinion expressed, by an independent public accounting firm, as well as reports on Form 6-K containing unaudited financial information for the first three quarters of each fiscal year, within 60 days after the end of each such quarter.

Item 11. *Quantitative and Qualitative Disclosures about Market Risk*

Not applicable.

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 (No. 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 deposit for three month periods, at interest rates ranging from 5.2% to 5.515% and in short-term debentures.

Item 15. *[reserved]*

Item 16. *[reserved]*

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(a)	Memorandum of Association*
1(b)	Articles of Association
4	Lease Agreement for the Company's Headquarters

* Incorporated by reference to the Registration Statement on Form F-1 (File No. 333-10752).

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/ YEHUDA ZISAPEL
Yehuda Zisapel
Chairman of the Board of Directors

Date: May 18, 2001