

**RADWARE LTD.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**As of December 31, 2000**

**RADWARE LTD.****INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of  
Radware Ltd.:

We have audited the accompanying consolidated balance sheets of Radware Ltd. (an Israeli Corporation) as of December 31, 1999 and 2000, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States and in Israel, including those prescribed under the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Radware Ltd. as of December 31, 1999 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

LUBOSHITZ KASIERER  
Member Firm of Arthur Andersen

Tel-Aviv, Israel  
February 5, 2001

**RADWARE LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
**In thousands of U.S. dollars (except share data)**

	Note	December 31,	
		1999	2000
Current assets			
Cash and cash equivalents	(3)	68,747	4,501
Short-term bank deposits and debentures	(4)	—	126,323
Trade receivables, net	(5)	2,915	9,254
Other receivables and prepaid expenses		920	1,613
Inventories	(6)	782	4,174
Total current assets		<u>73,364</u>	<u>145,865</u>
Long-term loan	(7)	—	721
Property and equipment, net	(8)	<u>1,036</u>	<u>2,788</u>
Deposits with insurance companies	(10)	<u>254</u>	<u>676</u>
Security deposits		<u>80</u>	<u>45</u>
Total assets		<u>74,734</u>	<u>150,095</u>
Current liabilities			
Trade payables		1,813	6,677
Other payables and accrued expenses	(9)	<u>3,248</u>	<u>6,770</u>
Total current liabilities		<u>5,061</u>	<u>13,447</u>
Accrued severance pay	(10)	<u>254</u>	<u>672</u>
Minority's interest		<u>—</u>	<u>45</u>
Total liabilities		<u>5,315</u>	<u>14,164</u>
Commitments	(11)		
Shareholders' equity	(12)		
Ordinary shares of NIS 0.1 par value:			
Authorized — 30,000,000 shares (1999 — same)			
Issued and outstanding — 16,321,475 shares (1999 — 14,604,209 shares) . . .		360	401
Additional paid-in capital		71,817	131,541
Deferred compensation		(1,553)	(892)
Retained earnings (Accumulated deficit)		<u>(1,205)</u>	<u>4,881</u>
Total shareholders' equity		<u>69,419</u>	<u>135,931</u>
Total liabilities and shareholders' equity		<u>74,734</u>	<u>150,095</u>

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

**RADWARE LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**In thousands of U.S. dollars (except share data)**

	Note	For the year ended December 31,		
		1998	1999	2000
Sales .....	(14)	4,900	14,141	38,353
Cost of sales .....		899	2,269	6,123
Gross profit .....		4,001	11,872	32,230
Operating expenses				
Research and development expenses .....		1,081	2,099	5,465
Less — participation by the Chief Scientist of the Government of Israel .....		341	466	—
Research and development expenses, net .....		740	1,633	5,465
Marketing and selling expenses .....	(15)	4,205	9,678	24,622
General and administrative expenses .....		298	1,137	3,127
Total operating expenses .....		5,243	12,448	33,214
Operating loss .....		(1,242)	(576)	(984)
Financing income (expenses), net .....		(11)	856	7,434
Income (loss) before taxes on income .....		(1,253)	280	6,450
Taxes on income .....	(13)	—	—	(387)
Income (loss) after taxes on income .....		(1,253)	280	6,063
Minority's interest .....		—	—	23
Net income (loss) .....		(1,253)	280	6,086
Net income (loss) per ordinary share				
Basic .....		(0.16)	0.03	0.38
Diluted .....		(0.16)	0.02	0.35
Weighted average number of ordinary shares outstanding used in computing per share amounts:				
Basic .....		7,777,635	11,174,639	15,874,172
Diluted .....		7,777,635	12,472,318	17,602,005

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

## RADWARE LTD.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

	Ordinary shares		Additional paid-in capital	Deferred compensation	Retained Earnings (Accumulated deficit)	Total
	Shares	Amount				
<b>Balance as of December 31,</b>						
1997 .....	6,350,400	—	—	—	(232)	(232)
Shares issued .....	—	7	—	—	—	7
Shares issued on conversion of debentures .....	3,176,469	9	4,121 (*)	—	—	4,130
Deferred compensation .....	—	—	141	(141)	—	—
Amortization of deferred compensation .....	—	—	—	53	—	53
Net loss .....	—	—	—	—	(1,253)	(1,253)
<b>Balance as of December 31,</b>						
1998 .....	9,526,869	16	4,262	(88)	(1,485)	2,705
Shares issued in private placement .....	1,577,340	2	8,898 (**)	—	—	8,900
Shares issued in an initial public offering .....	3,500,000	82	56,749 (***)	—	—	56,831
Stock split in the form of share dividend .....	—	260	(260)	—	—	—
Deferred compensation .....	—	—	2,192	(2,192)	—	—
Forfeited options .....	—	—	(24)	24	—	—
Amortization of deferred compensation .....	—	—	—	703	—	703
Net income .....	—	—	—	—	280	280
<b>Balance as of December 31,</b>						
1999 .....	14,604,209	360	71,817	(1,553)	(1,205)	69,419
Shares issued in secondary offering .....	1,250,000	31	59,759 (****)	—	—	59,790
Employee options exercised ...	467,266	10	—	—	—	10
Deferred compensation .....	—	—	63	(63)	—	—
Forfeited options .....	—	—	(98)	98	—	—
Amortization of deferred compensation .....	—	—	—	626	—	626
Net income .....	—	—	—	—	6,086	6,086
<b>Balance as of December 31,</b>						
2000 .....	<u>16,321,475</u>	<u>401</u>	<u>131,541</u>	<u>(892)</u>	<u>4,881</u>	<u>135,931</u>

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

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

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

(\*\*\*\*) Net of issuance expenses of \$4,863.

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

**RADWARE LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**In thousands of U.S. dollars**

	For the year ended December 31,		
	1998	1999	2000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income (loss) .....	(1,253)	280	6,086
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Income and expenses not affecting operating cash flows:			
Depreciation .....	44	132	616
Amortization of deferred stock compensation .....	53	703	626
Minority's share in loss .....	—	—	(23)
Interest accrued on convertible debentures .....	168	—	—
Interest accrued on bank deposits .....	—	—	(593)
Severance pay, net .....	10	(18)	(4)
Changes in operating assets and liabilities:			
Increase in trade receivables .....	(804)	(2,076)	(6,339)
Increase in other receivables and prepaid expenses .....	(459)	(449)	(613)
Increase in inventories .....	(293)	(217)	(3,392)
Increase in trade payables .....	121	1,477	4,864
Increase in other payables and accrued expenses .....	605	2,539	3,522
Net cash provided by (used in) operating activities .....	<u>(1,808)</u>	<u>2,371</u>	<u>4,750</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property and equipment .....	(130)	(980)	(2,404)
Proceeds from sale of property and equipment .....	—	28	37
Short term bank deposits .....	—	—	(125,732)
Security deposits .....	—	(80)	(45)
Long-term loan .....	—	—	(721)
Net cash used in investing activities .....	<u>(130)</u>	<u>(1,032)</u>	<u>(128,865)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from shares issued to minority shareholders .....	—	—	68
Proceeds from employee options exercised .....	—	—	10
Proceeds from shares issued in a secondary offering .....	7	72,041	64,654
Share issuance expenses .....	(39)	(6,310)	(4,863)
Net cash provided by (used in) financing activities .....	<u>(32)</u>	<u>65,731</u>	<u>59,869</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS .....</b>	<b>(1,970)</b>	<b>67,070</b>	<b>(64,246)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD .....</b>	<b><u>3,647</u></b>	<b><u>1,677</u></b>	<b><u>68,747</u></b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD .....</b>	<b><u><u>1,677</u></u></b>	<b><u><u>68,747</u></u></b>	<b><u><u>4,501</u></u></b>
<b>NONCASH ACTIVITIES</b>			
Conversion of convertible debentures .....	<u>4,168</u>	—	—

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

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****In thousands of U.S. dollars****Note 1 — General**

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

B. During the year, the Company established six wholly owned subsidiaries. In Australia the Company set up a subsidiary in which it has a 74.9% holding.

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

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

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

*Nonmonetary items* — at historical exchange rates.

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

All exchange gains and losses from the remeasurement mentioned above (which are immaterial for all periods presented) are reflected in the statement of operations. The representative rate of exchange at December 31, 2000 was US\$ 1.00 – 4.041 New Israeli Shekels (“NIS”) (December 31, 1999 and 1998 – NIS 4.153 and 4.160, respectively).

**Note 2 — Significant Accounting Policies**

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

*A. Principles of Consolidation*

The financial statements include the accounts of the Company and its wholly-owned subsidiaries. The Company’s principal subsidiary is Radware Inc. (U.S.A.). Material intercompany balances and transactions have been eliminated.

*B. Cash and Cash Equivalents*

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

*C. Short-Term Bank Deposits and Debentures*

The Company accounts for investments under Statement of Financial Accounting Standards (“SFAS”) No. 115, Accounting for Certain Investments in Debt and Equity Securities. The short-term bank deposits

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars**

and marketable debentures are classified as “trading” and are stated at market value. Gains and losses are included in financing income (expenses), net.

*D. Allowance for Doubtful Accounts*

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

*E. Inventories*

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

*F. Property and Equipment*

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

*G. Provision for Warranty Costs*

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

*H. Revenue Recognition*

Revenues from product sales are recognized upon shipment and when collection is probable. A provision is made for returns based on the Company's experience. Revenue from sale of Post-Contract Support (“PCS”) services is recognized ratably over the service period. PCS services are generally provided under standard contracts with a one year term.

*I. Research and Development Costs*

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

*J. Income Taxes*

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

*K. Fair Value of Financial Instruments*

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

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars***L. Basic and Diluted Net Income (Loss) Per Share*

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

Under the provisions of SFAS No. 128, basic net income (loss) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of ordinary shares outstanding. Diluted net income (loss) per share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of shares and dilutive share equivalents then outstanding. The total number of shares related to the outstanding options excluded from the calculations of diluted net loss per share were 1,541,322 for the year ended December 31, 1998. A reconciliation between the numerator and denominator of Basic EPS and Diluted EPS for the years ended December 31, 1999 and 2000, are as follows:

	<u>1999</u>	<u>2000</u>
Net Income .....	280	6,086
Basic:		
Weighted average shares used in computing basic net income per share .....	<u>11,174,639</u>	<u>15,874,172</u>
Basic net income per share .....	<u>0.03</u>	<u>0.38</u>
Diluted:		
Shares used above .....	11,174,639	15,874,172
Adjusted to reflect weighted effect of diluted shares due to share options .....	<u>1,297,679</u>	<u>1,727,833</u>
	<u>12,472,318</u>	<u>17,602,005</u>
Diluted net income per share .....	<u>0.02</u>	<u>0.35</u>

*M. Share-Based Compensation*

The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and the accounting rules set forth in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" including the FASB issued Interpretation 44, "Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB 25." The Company has provided the necessary pro forma disclosures as if the fair value method had been applied (See Note 12(D)).

*N. Use of Estimates*

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

*O. Recently Issued Accounting Pronouncements*

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars**

and losses to offset related results on the hedged item in the income statement. SFAS 133 is effective for fiscal years beginning after June 15, 2000. The Company believes that the adoption of SFAS 133 will not have a material effect on its financial statements.

**Note 3 — Cash and Cash Equivalents**

	<b>December 31</b>	
	<b>1999</b>	<b>2000</b>
Cash in banks .....	1,440	465
Bank deposits:		
In U.S. Dollars (bearing annual interest rate of 5.0% to 6.4%) .....	67,307	3,164
In other currencies .....	—	872
	<u>68,747</u>	<u>4,501</u>

**Note 4 — Short-Term Bank Deposits and Debentures**

	<b>December 31</b>	
	<b>1999</b>	<b>2000</b>
Bank deposits:		
In U.S. Dollars (bearing annual interest rate of 6.5% to 6.7%) .....	—	105,493
Short-term debentures .....	—	20,830
	<u>—</u>	<u>126,323</u>

**Note 5 — Trade Receivables, Net**

Trade receivables are presented net of allowance for doubtful accounts in the amount of \$400 (1999 — \$220).

**Note 6 — Inventories**

	<b>December 31</b>	
	<b>1999</b>	<b>2000</b>
Materials and components .....	13	219
Work in progress .....	74	2,456
Finished goods .....	695	1,499
	<u>782</u>	<u>4,174</u>

**Note 7 — Long Term Loan**

The Company entered into a loan agreement with a private company. The loan is convertible into preferred shares of that company.

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars****Note 8 — Property and Equipment, Net**

	<b>December 31</b>	
	<b>1999</b>	<b>2000</b>
<b>COST</b>		
Research and development equipment .....	135	614
Computer equipment .....	470	1,865
Leasehold improvements .....	71	199
Motor vehicles .....	363	400
Office furniture and equipment .....	177	425
	<u>1,216</u>	<u>3,503</u>
<b>ACCUMULATED DEPRECIATION</b>		
Research and development equipment .....	30	134
Computer equipment .....	74	406
Leasehold improvements .....	6	23
Motor vehicles .....	54	88
Office furniture and equipment .....	16	64
	<u>180</u>	<u>715</u>
	<u>1,036</u>	<u>2,788</u>

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

For the years ended December 31, 1998, 1999 and 2000, depreciation expense was \$44, \$132 and \$616, respectively.

**Note 9 — Other Payables and Accrued Expenses**

	<b>December 31</b>	
	<b>1999</b>	<b>2000</b>
Deferred income .....	1,092	2,410
Accrued expenses .....	803	2,298
Related company .....	692	—
Employees and government institutions .....	383	1,028
Provision for warranty costs .....	241	516
Other .....	37	518
	<u>3,248</u>	<u>6,770</u>

**Note 10 — Accrued Severance Pay**

Under Israeli law and labor agreements, the Company is required to make severance payments to its dismissed employees and employees leaving its employment in certain other circumstances. The Company's severance pay liability to its employees, which is calculated on the basis of the salary of each employee for the last month of the reported period multiplied by the years of such employee's employment, is reflected in the Company's balance sheet on the accrual basis, and is partially funded by purchase of insurance policies in the name of the Company. Severance pay expense for the periods ended December 31, 1998, 1999 and 2000 amounted to \$60, \$171 and \$418, respectively.

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars****Note 11 — Commitments**

The Company operates mainly from leased premises in Tel-Aviv and Jerusalem, Israel and in New Jersey and California in the United States. Lease agreements expire in the years 2001 to 2004 (some with renewal options). Annual minimum future rental payments due by the company and its subsidiaries, at exchange rates in effect on December 31, 2000, are approximately as follows:

2001 .....	754
2002 .....	435
2003 .....	435
2004 .....	<u>435</u>
	<u>2,059</u>

**Note 12 — Shareholders' Equity**

A. In June 1999, the Company issued 1,577,340 Series B preferred shares in a private placement to a group of investors at an aggregate purchase price of \$8,900 (net of issuance expenses). On August 30, 1999, the Company increased its authorized share capital to 30,000,000 shares of NIS 0.1 par value per share and all outstanding preferred shares were converted into an identical number of ordinary shares. In October 1999, the Company effected a 27 to 1 stock split in the form of a share dividend. All references to per share amounts and the number of shares in these financial statements have been restated to reflect the above changes.

B. In October 1999, the Company issued 3,500,000 ordinary shares in an initial public offering on the NASDAQ National Market in consideration for \$56,831 (net of issuance expenses).

C. In January 2000, the Company issued 1,250,000 ordinary shares in a secondary offering on the NASDAQ National Market in consideration for \$59,790 (net of issuance expenses).

D. In 1997, the Company adopted a key employee share incentive plan which provides for the grant by the Company of option awards to purchase up to an aggregate of 1,587,600 ordinary shares to officers and employees of the Company and its subsidiaries. The vesting period for these options ranges from immediate vesting upon grant to ratable vesting over a four year period. The options expire 62 months from the date of issuance. The exercise price of option awards under the plan will generally be at varying prices ranging from \$0 to the fair market value at the date of the grant. In 1999 and in 2000, the plan was increased by an additional 226,800 and 1,500,000 Ordinary shares, respectively.

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars**

Transactions related to the above discussed options during the years ended December 31, 1998, 1999 and 2000 and the weighted average exercise prices per share and weighted average fair value of the options at the date of grant are summarized as follows:

	<u>Outstanding options</u>	<u>Weighted average exercise price per share</u>	<u>Weighted average fair value of options granted</u>
Outstanding December 31, 1997 .....	982,692	\$ —	\$ —
Options granted .....	140,508	0.03	1.01
Outstanding December 31, 1998 .....	1,123,200	—	
Options granted .....	557,540	4.68	8.48
Options forfeited .....	(50,004)	—	
Outstanding December 31, 1999 .....	1,630,736	1.60	
Options granted .....	1,184,719	17.09	10.05
Options exercised .....	(467,266)	—	
Options forfeited .....	(19,936)	17.57	
Outstanding December 31, 2000 .....	<u>2,328,253</u>	<u>\$ 9.68</u>	

The following table summarizes information about options outstanding and exercisable at December 31, 2000:

<u>Options outstanding</u>				<u>Options exercisable</u>	
<u>Exercise price</u>	<u>Number outstanding at December 31, 2000</u>	<u>Weighted- average remaining contractual life</u>	<u>Weighted- average exercise price</u>	<u>Number outstanding at December 31, 2000</u>	<u>Weighted- average exercise price</u>
\$0.03	916,106	2.41	\$ —	536,428	\$0.03
4.59	38,583	3.61	4.59	—	—
5.73	113,400	3.91	5.73	—	—
16.00	1,131,750	4.56	16.00	—	—
18.00	83,414	3.73	18.00	4,000	18.00
46.00	45,000	4.06	46.00	—	—
	<u>2,328,253</u>			<u>540,428</u>	

The aggregate amounts of deferred compensation recognized arising from the difference between the exercise price and the fair market value on the date of grant of \$2,333 is included in shareholders' equity and is being amortized over the vesting periods of the respective options in accordance with APB 25. The balance of unamortized deferred compensation at December 31, 2000, is \$892. Under APB 25 the deferred compensation that has been charged to operations for the year ended December 31, 2000 amounted to \$626 (year ended December 31, 1999 — \$703).

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars**

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

	For the year ended December 31,		
	1998	1999	2000
Net income (loss)			
As reported .....	(1,253)	280	6,086
Pro forma .....	(1,253)	(121)	1,887
Basic income (loss) per share:			
As reported .....	(0.16)	0.03	0.38
Pro forma .....	(0.16)	(0.01)	0.12
Diluted income (loss) per share:			
As reported .....	(0.16)	0.02	0.35
Pro forma .....	(0.16)	(0.01)	0.11

Under SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 1998, 1999 and 2000: (1) expected life of the options of 2.75, 2.33 and 2.4 for years ended December 31, 1998, 1999 and 2000, respectively; (2) no dividend yield (1998, 1999 — same); (3) expected volatility of 103% (1998 — 0%, 1999 — 274%) and (4) risk-free interest rate of 5% (1998, 1999 — same).

**Note 13 — Taxes on Income**

A. The Company submitted an investment program in June 1998 to the Investment Center for approval as an approved enterprise in accordance with the Law for the Encouragement of Capital Investments, 1959 (the "Law") and the Investment Center granted an approval in December 1998 for establishing an approved enterprise in Tel-Aviv. As the Company has elected to apply the alternative benefits method for this program, the Company will be entitled to a tax exemption with respect to the income derived from the approved enterprise program for two years and will be taxed at a 25% rate for five additional years (8 years, if foreign shareholding in the Company exceeds 25%). As the Company's manufacturing and part of its research and development facilities are located in Jerusalem, the Company has submitted a request to the Investment Center to reconsider its investment program to qualify for the benefits afforded to an approved enterprise established in Jerusalem, and requested an extension to continue the investments under the approved program at its facilities in Jerusalem during 2001. If the requests are accepted, the Company will be entitled to a tax exemption with respect to part of the income derived from the approved enterprise program in Jerusalem for six years and will be taxed at a 25% rate for one additional year. The six-year period of full tax exemption may be extended to a ten year period without any further tax benefit, if the Company applies to the Investment Center for recognition as a "High Technology" facility and this status is recognized. The Company is not sure that the approval for the consideration as an approved enterprise in Jerusalem or the investment extension will be granted.

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

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

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars**

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

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

B. The Company is subject to the Income Tax Law (Inflationary Adjustments), 1985, measuring income on the basis of changes in the Israeli Consumer Price Index.

C. As of December 31, 2000, the Company and its U.S. subsidiary have net operating loss carryforwards for tax purposes in the amount of approximately \$7,500. No provision for taxes on income is required in respect of reported net income, due to utilization of tax losses generated in previous years.

Details of deferred tax assets are as follows:

Deferred tax assets, mainly in respect of reserves and allowances not currently deductible .....	1,900
Valuation allowance .....	<u>(1,900)</u>
	<u>—</u>

D. Income taxes are in respect of taxable profits in subsidiaries of the Company.

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

**Note 14 — Sales**

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

	<b>For the year ended December 31,</b>		
	<b><u>1998</u></b>	<b><u>1999</u></b>	<b><u>2000</u></b>
The Company's sales by geographic areas are as follows:			
North America (principally United States) .....	3,206	7,935	18,062
Europe .....	523	2,254	8,697
Asia and Australia .....	1,171	3,811	10,780
Other .....	<u>—</u>	<u>141</u>	<u>814</u>
	<u>4,900</u>	<u>14,141</u>	<u>38,353</u>

**Note 15 — Marketing and Selling Expenses**

	<b>For the year ended December 31,</b>		
	<b><u>1998</u></b>	<b><u>1999</u></b>	<b><u>2000</u></b>
Marketing and selling expenses include royalties to the Government of Israel .....	<u>152</u>	<u>515</u>	<u>776</u>

**RADWARE LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****In thousands of U.S. dollars****Note 16 — Concentration of Credit Risk**

For the periods ended December 31, 1998, 1999 and 2000, no single customer accounted for more than 10% of the Company's sales. As of December 31, 2000, one customer represented 16% of trade receivables. As of December 31, 1999, one customer represented 12% of trade receivables. The Company does not require collateral to support credit sales. Allowances are maintained for potential credit losses.

**Note 17 — Related Party Balances and Transactions***A. Balances with Related Parties*

	<b>December 31,</b>	
	<b>1999</b>	<b>2000</b>
Trade receivables .....	357	1,429
Trade payables .....	536	3,362
Other payables and accrued expenses .....	694	265

*B. Transactions with Related Parties*

	<b>For the year ended December 31,</b>		
	<b>1998</b>	<b>1999</b>	<b>2000</b>
Sales .....	807	1,239	3,940
Cost of sales .....	689	1,089	6,747
Operating expenses .....	1,392	519	1,060
Purchase of property and equipment .....	—	171	313

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

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