

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549



FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR 15d-16  
UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the month of May 2006

**RADVISION LTD.**  
(Name of Registrant)



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5-1-06*

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**THOMSON  
FINANCIAL**

24 Raoul Wallenberg Street, Tel Aviv 69719, Israel  
(Address of Principal Executive Office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F  Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes  No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82- \_\_\_\_\_

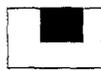
FILED SOLELY FOR THE PURPOSE OF DEPOSITING A COPY OF THE REGISTRANT'S ANNUAL REPORT TO SHAREHOLDERS WITH THE SECURITIES AND EXCHANGE COMMISSION

6-K Items

1. RADVision Ltd. Annual Report for the year ended December 31, 2005.

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ITEM 1



**RADVISION**<sup>®</sup>  
Delivering the Visual Experience<sup>™</sup>



## 2005 ANNUAL REPORT

*Delivering World-Class Infrastructure and  
Developer Solutions That Enable Video,  
Voice and Multimedia Communication  
Over IP and 3G Networks*

Dear Shareholder,

2005 was a landmark year for RADVISION. Not only was this a year of impressive financial results, including record revenues and profitability, but also a year of strategic growth in our product lines and with our key channel partners.

We deepened our relationships with our key partners, and added an additional OEM and channel partners to better serve our regions. We placed a special emphasis on working with existing channels using high touch and proactive methods

Seizing on the importance of the emerging PC-based Desktop video collaboration market, we acquired substantial assets of First Virtual Communications and brought the Click to Meet™ product and technology under the RADVISION umbrella.

Identifying the importance of the Federal market, we won continuing and new business in that sector. The acquisition of Click to Meet brought with it an existing Federal customer base and additional opportunities on which we capitalized. We also received a key contract through Northrop Grumman for the supply of our traditional hardware product lines and management software to power the largest videoconferencing network in the world, being deployed by the Department of Defense.

We brought to market key products targeted at the 3G Service Provider sector, and saw that our 3G related revenues grew and contributed to the solid financial performance in 2005.

We continued to strengthen our market leading developer toolkit business by augmenting the product line with the latest tools needed by telecommunications OEMs. We were rewarded with stable growth in that sector.

Noting the importance of the Asia Pacific, we invested in the growth of this region by putting in place the right sales organization and distribution network. We also turned our attention to strengthening the EMEA and Americas sales organizations. In EMEA we opened offices in France, Germany, Italy and Spain. In the Americas we reorganized our sales force for better partner management and brought in a new General Manager.

**RECORD FINANCIAL PERFORMANCE**

Our record year is based on growth in all of our product lines, with encouraging results in our future growth lever market segments – the 3G and Desktop markets.

We finished the year with \$74.0 million in revenues, an increase of over 15.2% from 2004. Our gross profit was \$60.9 million representing 82.3% of revenues and up \$10.1 million relative to 2004. Keeping close attention to expenses, we delivered an operating profit of \$11.5 million, versus \$4.1 million the previous year. Net income for 2005 rose to \$14.7 million, a growth of 146% over 2004. This represents \$0.66 per diluted share for 2005, compared with \$0.28 in 2004. We also reported a positive cash flow (including deposits and marketable securities) of \$14.6 million, in comparison to \$10.5 million in 2004. Our balance sheet remains very strong, and we ended 2005 with cash and cash equivalents of approximately \$125 million, or \$5.92 per basic share and no debt.

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## **STRATEGIC ACQUISITION**

In March 2005, we acquired substantial assets of First Virtual Communications and their Click to Meet product, as well as their customer base including significant penetration into the United States Federal market. We were successful in hiring and retaining many of their key employees.

We successfully integrated not only the Click to Meet product into the RADVISION portfolio, but also the Click to Meet sales, marketing and development team into the RADVISION organization. Our revenues in 2005 for Click to Meet were in line with our guidance.

## **STRATEGIC PRODUCT OFFERINGS**

We introduced key products in 2005 in keeping with our commitment to leadership in the visual communications market and in the telecommunications developers market.

In the NBU we introduced the Click to Meet product to target Desktop PC visual collaboration. In doing so, we have complemented our hardware based room conferencing product line with a software based PC visual collaboration solution that has the requisite price points and scalability for pan-Enterprise deployments to all desktops. We view strategic partners such as Microsoft and IBM as the key drivers to desktop adoption of visual collaboration tools. By working with key industry application providers, we also provide Click to Meet solutions completely pre-integrated with popular tools such as Microsoft® LCS Office Communicator and Live Meeting.

We introduced the PathFinder™ product and we now provide video connectivity across enterprise firewall boundaries. We see this product as an enabler to visual collaboration and in line with our infrastructure offering that allows connectivity between all standards based endpoints on the network.

Our iContact™ product targeted at Service Providers is an innovative application that adds video conferencing to 3G mobile call center applications. This product was released in 2005 and sold to key customers. The iContact product integrates with our Interactive Video Platform. The Interactive Video Platform is a key product in providing video services to 3G operators and several service provider customers are already using it for various 3G video services such as video-conferencing. These products integrate with our veteran SCOPIA™ 3G Gateway.

In the TBU, we expanded on our leading SIP product line with additional functionality, including a Java interface, to meet the growing demand of developers. We spearheaded improvement to the 3G-324M standard and our modifications were adopted by the ruling standards bodies. We invested heavily in IP Multimedia Subsystem (IMS) research and development and IMS compliant toolkits will be made available in 2006. The IMS standard has gained wide acceptability across the 3G mobile and Cable networks telecommunications industry.

**STRATEGIC PARTNERSHIPS**

We invested in maintaining and expanding our relationships with key partners. The revenues from our main OEM partner, Cisco, continued to grow in 2005 Together, we won a key contract with the Department of Defense that integrates our MCU and Gateway Hardware and iVIEW Network management software. The DoD is expected to deploy our products as part of the DVS-II network which is the largest videoconferencing network in the world.

In EMEA, we signed an OEM agreement with Aethra who is selling our NBU hardware products to their customer base. We integrated our Click to Meet products with Microsoft's Real Time Collaboration (RTC) products through close collaboration with them.

We expanded our relationship with SONY by providing them with a SONY branded version of our iVIEW Management software so that this can be sold as an integrated solution with our hardware MCU products.

**EXPANDING OUR MARKETS**

We see our NBU room system market along with the TBU developer toolkit market as the traditionally stable sources of revenue to the company and we continue to invest in these markets to ensure our market share and revenue stream from these segments. Furthermore, we have taken strategic steps to provide future growth levers to the company in the form of PC Desktop collaboration tools and 3G mobile video enabling products. Both of these markets have great potential and our strategic product offering described above is designed to target these markets effectively. We continued to invest in 2005 in research, development, sales, and marketing to properly address these segments.

**SMOOTH MANAGEMENT TRANSITION**

The last quarter of 2005 was a transition period during which RADVISION's CEO from 2001-2005, Gadi Tamari, transferred his duties over to me. I was fortunate enough during my five year career at RADVISION to manage both the TBU and the NBU, and that experience contributed significantly to the smooth transition and prepared me for the head leadership role at RADVISION.

RADVISION is a visionary company with leadership in its fields of activity. As I look forward towards 2006 and the commitment of market makers to provide visual collaboration tools to the desktop, to continue the proliferation of 3G video-enabled networks, and to transitioning networks to IMS, I see great opportunity lying ahead. I thank you for your continued support for RADVISION and hope you share my enthusiasm for RADVISION's future.

Sincerely,



Boaz Raviv  
Chief Executive Officer  
RADVISION

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**RADVISION LTD. AND ITS SUBSIDIARIES**

**2005 Annual Report**

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#### **Factors that could affect operating results**

*Except for historical information, the matters discussed in this annual report involve risks and uncertainties that could cause actual results to differ materially from those provided by such forward-looking statements. Factors that could cause actual results to differ materially from these forward-looking statements include, but are not limited to, general business conditions in the industry, changes in demand for products, the timing and amount or cancellation of orders and other risks detailed from time to time in RADVISION's filings with the Securities Exchange Commission, including RADVISION's Form 20-F Annual Report. These documents contain and identify other important factors that could cause actual results to differ materially from those contained in our projections or forward-looking statements. Forward-looking statements are sometimes identified by the use of the words "believe," "expect" or "intend." Stockholders and other readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update publicly or revise any forward-looking statement.*

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## GENERAL OVERVIEW

We were incorporated under the laws of the State of Israel in January 1992, commenced operations in October 1992 and commenced sales of our products in the fourth quarter of 1994. We are a public limited liability company under the Israeli Companies Law, 5759-1999 and operate under this law and associated legislation. Our registered offices and principal place of business are located at 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel, and our telephone number is +972-3-767-9300. Our address on the Internet is [www.radvision.com](http://www.radvision.com). The information on our website is not incorporated by reference into this annual report.

We are the industry's leading provider of high quality, scalable and easy-to-use products and technologies for videoconferencing, video telephony, and the development of converged voice, video and data over IP and 3G networks. Hundreds of thousands of end-users around the world today communicate over a wide variety of networks using products and solutions based on or built around our multimedia communication platforms and software development solutions.

We have approximately 450 customers worldwide including Aethra, Alcatel, Cisco, Lucent, Microsoft, Nortel, NTT/DoCoMo, Orange Telecom, Philips, Panasonic, Qualcomm, Samsung, Shanghai Bell, Siemens, Sony and Telecom Italy.

Since 2001, we have conducted our business through two separate business units corresponding to our two product lines to enable our product development and product marketing teams to respond quickly to evolving market needs with new product introductions.

Our Networking Business Unit, or NBU, offers one of the broadest and most complete set of multimedia communication and videoconferencing network solutions for IP, ISDN, SIP, H.323 and 3G-based networks, supporting most end points in the industry today. These products are sold to the enterprise market, U.S. federal government and service provider market.

On March 15, 2005, following a bidding process held under the supervision of a United States Bankruptcy Court, we acquired substantially all of the assets of FVC and its wholly owned subsidiary, CUseeMe Networks, Inc., on an "as is" basis. We acquired FVC's leading software products that enable interactive voice, video and data collaboration over IP-based networks. The products provide cost-effective, integrated end-to-end solutions for large-scale deployments from the desktop to the conference room and also enable best-of-breed collaborative conferencing solutions to be extended to ISDN and ATM networks. FVC's Click to Meet™ products provide integrated and scalable desktop conferencing solutions. Click to Meet™ products are fully integrated with a single software architecture consisting of the Conference Server, the Conference Client and the Middleware to tie them together. Click to Meet™ products are widely used worldwide and offer a robust set of functionalities. The transaction provided for a cash purchase price of \$7.15 million. Due to certain cash adjustments the actual purchase price was approximately \$7.0 million.

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We also hired approximately thirty-one former employees of FVC that were based in Nashua, New Hampshire, and who were involved in marketing, selling and supporting the acquired FVC products. In the year ended December 31, 2005, we recognized revenues of \$5.1 million from Click to Meet™ products as part of our NBU segment.

In the enterprise market we sell to resellers, OEMs, and system integrators who use our infrastructure products to develop and install advanced IP and ISDN-based visual communication systems to the company meeting room and employee desktop. The NBU also provides video services solutions to service providers, both 3G mobile and IP wireline. We sell our products and platforms to major telecom equipment vendors, such as Cisco and Alcatel, which then integrate our solutions into their larger communications platforms/architectures. These integrated solutions enable the delivery of real-time interactive IP and 3G-based multimedia streaming and video telephony services over both broadband connections (cable, DSL, etc.) and 3G mobile networks.

Our Technology Business Unit, or TBU, is a one-stop-shop for developer platforms that equipment vendors use to build voice and video over IP and 3G products and solutions. The TBU provides protocol development tools and platforms, as well as associated solutions such as testing platforms and IP phone toolkits that enable equipment vendors and service providers to develop and deploy new IP and 3G-based converged networks, services, and technologies.

Our TBU solutions include developer toolkits for SIP, MEGACO/H.248, MGCP, H.323, and 3G-324M and our ProLab™ Test Management Suite and IP Phone Toolkit. Our toolkits have been used by developers in a wide range of environments from chipsets to simple user devices like IP phones, and from integrated video systems through carrier class network devices like gateways, switches, soft switches and 3G multimedia gateways.

Both business units also provide professional services to customers, assisting them to integrate our technology into their products and to customize our products to their specific needs.

Our capital expenditures for the years ended December 31, 2003, 2004 and 2005 were approximately \$1.3 million, \$2.3 million and \$2.0 million, respectively. These expenditures were principally for research and development equipment, office furniture and equipment and leasehold improvements.

## **BUSINESS OVERVIEW**

### **Overview and Strategy**

Our goal is to be the leading provider of solutions that enable real-time multimedia (voice, video and data) collaboration and communication over packet and 3G networks. We provide solutions at every level – protocol developer toolkits, professional services, network infrastructure, as well as integrated solutions that complement the communication solutions of other vendors such as those from Alcatel, Cisco, Microsoft and Sony.

We believe that the combination of offering IP-centric networking products, along with software toolkits, positions us as a key enabling vendor in the evolution of IP communications. Key elements of our strategy include the following:

*Maintain and Extend our Technology Leadership.* We believe that we have established ourselves as a technology leader in providing core-enabling technology for a broad range of IP and 3G communication products and services. In this regard, in 2004 we announced support both for Microsoft's Office Live Communications Server 2005/Office Communicator and Cisco's desktop IP-video telephony architecture. In the service provider marketplace, in 2004 we also announced an advanced 3G Interactive Video Platform (IVP) and the launch of a new carrier-grade architecture called SCOPIA™.

We have accumulated extensive knowledge and expertise as designers and developers of commercial products and technologies for real-time packet-based communication. We continue to place considerable emphasis on research and development to expand the capabilities of our existing products, to develop new products and to improve our existing technology and capabilities. We believe that our future success will depend upon our ability to maintain our technological leadership; bring value to the communications solutions of our partners' such as Cisco, Microsoft, Alcatel, Aethra, Comverse and others; enhance our existing products; and introduce on a timely basis new commercially viable products addressing the needs of our customers. We intend to continue to allocate significant resources to research and development.

- *Enable the Migration of Visual Communications from the Traditional Conference Room (Videoconferencing) Application to the Desktop, the Home, and onto the Road Over IP and Wireless.* We have been working with leading technology vendors such as Cisco and Microsoft as well as developing partnerships with broadband and wireless service providers, to transform videoconferencing from a meeting room application to a new mode of personal communication. The announcement of our support of Microsoft's Real Time Communication Server in 2005 and the integration between the live server of Microsoft and ours, allowing video conferencing and data collaboration, was a significant step in this direction. In 2004, Cisco announced and began deploying desktop video networks based, in part, on our technology. We have initiated pilots, based on our Microsoft solution, with enterprise customers around the world. 3G operators around the world have performed pilots of our powered video telephony and video streaming applications. Our platforms are key technologies in all of these solutions and we will continue to work to expand the use of video for communications and entertainment at the desktop, in the home and over broadband mobile networks.
- *Strengthen and Expand our Relationships with our OEM Customers.* We have established and continue to maintain collaborative working relationships with many company's in the IP communication market, including Aethra, Alcatel, Cisco, Hutchinson, Nokia, Nortel, Samsung, Siemens and Sony. We work closely with our OEM customers to integrate our products and core technology into their solutions.

Our core technology and our system design expertise enable us to assist these customers in the development of complete solutions that contain enhanced features and functionality compared to competitive alternatives. We strive to establish long-term relationships with our OEM customers by starting with a few products and subsequently expanding these relationships by increasing the number and range of products sold to these customers. We intend to expand the depth and breadth of our existing OEM relationships, while initiating similar new relationships with other leading OEMs focused on the IP communication market.

- *Become a Key Enabling Technology Solution for IP Communications.* We continue to strive to ensure that our infrastructure solutions are key enabling components in larger solution vendors' portfolios. To that end, in 2005, we announced the further deepening of our relationships with Sony, Cisco and Microsoft and also announced a new OEM relationship with Aethra. We also substantially increased the number of telecom equipment vendors who use our video services platform as part of their larger solutions.
- *Continue to Offer New and Enhanced Products and Features.* We believe that we have consistently been either first, or among the first, to market products that support real-time voice, video and data communication over packet networks. We were the first-to-market with IP gateways that provide combined voice, video and data functionality, the first-to-market with software development kits for the development of H.323-compliant IP communication products and applications, and the first to announce support for SIP (Session Initiation Protocol) in our infrastructure platform. We were also the first to offer a 3G toolkit and 3G to IP (H.323 and SIP) bridging. We continue to be active in enhancing industry standards by improving the call set-up time in video cellular calls, contributing to Firewall/NAT (network address translation) traversal standardization (H.460.18/19) and H.248 video enhancements. We intend to utilize our technological expertise as a basis for market leadership by striving to be first-to-market with new and enhanced products and features that address the increasingly sophisticated needs of our customers and the evolving markets they serve. In addition, we believe that our participation in the drafting of industry standards gives us the ability to quickly identify emerging trends enabling us to develop new products and technologies that are at the forefront of technological evolution in the IP communication industry.
- *Deepen the Distribution Channels for our Products.* We intend to continue to focus our sales and marketing efforts on deepening the relationship with our distribution channels. Channel partners provide us feedback from their customers, the end-users of our products, which gives us valuable insight into evolving industry trends and customer requirements. OEMs, resellers and systems integrators are all important channel partners for our products. They provide us with increased market presence through their distributor relationships and existing customer base. In addition, endorsements by key channel partners strengthen our brand name awareness.

- *Leverage Service Provider Opportunities.* We are working closely with telecom equipment providers, 3G mobile carriers, and residential IP (wireline) service providers to enable video services (both communications and streaming /entertainment) to be delivered to the home and to mobile devices. In 2005, our 3G products were commercially used for the first time. 3G carriers around the world continued to perform pilots and trials for our video services in 2005 and we expect that the market will continue to grow into general use in the next few years.
- *Enable Desktop Conferencing and Communication through Strategic Partners.* We plan to continue our efforts to maintain our position as a key enabling solution provider for major vendors' activities to drive visual communication beyond the meeting room and onto the desktop. In this regard, we intend to strengthen our relationship with Microsoft and its sales channels. We also intend to leverage our close relationship with Cisco and their efforts in enterprise video telephony by virtue of our Cisco AVVID (Architecture for Voice and Video Integrated Data) certification that we attained in early 2004 for certain products, such as MCUs (multipoint conferencing units) and Gateways, and the integration of such products into Cisco's MeetingPlace collaboration product.
- *Continue our Active Involvement in Shaping Industry Standards for IP Communication.* We actively participate in and contribute to the formulation of standards for IP communication. We intend to continue our active involvement in the organizations that define the standards for real-time communication over next generation packet networks. Our knowledge and expertise gained in participating in the development of these industry standards should enable us to continue to be among the first to market our products and technology based on new standards adopted. We work to continually improve, enhance and expand our core competency in real time IP communication protocols including H.323, SIP, MGCP, MEGACO and IMS (IP multimedia subsystem). Because of our involvement in defining these IP communication standards, we believe that we are well-positioned to quickly develop enhanced functionality and new products based on multiple protocols.

## **Our Business**

Our business is separated into two units: our videoconferencing networking business unit, or NBU, and our software developer toolkit business unit, or TBU. The discussion below of our business is separated by unit. In each section we provide an overview of our products, our competitive advantage, and industry trends that are beneficial to each unit and our business.

### **NETWORKING BUSINESS UNIT**

Our NBU provides powerful meeting room and desktop videoconferencing and video telephony infrastructure and middleware solutions, as well as video solutions, for 3G networks.

#### ***NBU Products***

Our award-winning multimedia communication, videoconferencing and video services network infrastructure products provide both the platform and applications to enable advanced video-based conferencing and collaboration functionality between any video-enabled device, such as a meeting room or a desktop videoconferencing end point, with other telephony and videoconferencing systems. Additionally, our portfolio of telecommunication carrier solutions enables the development and delivery of real-time video services (both streaming and communications) to wireless, wireline, and broadband mobile users. Our solution can be used by institutions, enterprises, and service providers to create high quality, easy-to-use voice, video, and data communication, collaboration, and entertainment environments, regardless of the communication network -- IP, SIP, H.323, ISDN or next generation 3G.

Our core infrastructure solution for the enterprise is viaIP™, a customizable, scalable array of ports, management solutions, and custom functionality with which customers can design and quickly deploy a highly configured, highly scalable visual communication network for each client's individual needs. With the viaIP product line, the customer can choose the best port configuration, management solution and additional applications, and the entire solution is delivered in an integrated chassis.

Within the viaIP product line we offer INVISION™, a plug-and-play line of videoconferencing network appliances targeted at the enterprise market. INVISION offers an off-the-shelf, completely pre-configured solution with the functionality of a complete IP/ISDN videoconferencing infrastructure, from centralized management and multipoint conferencing to gateway services and value-added applications, in an integrated, easy-to-order and easy-to-install device.

To complement the viaIP product, we offer the iVIEW™ family of management applications to meet such videoconferencing needs such as robust network management and easy-to-use conference scheduling.

iVIEW has been extended to address the desktop conferencing market which requires a scalable, robust software-based architecture to enable the delivery of video services to the employees' video phones and personal computers, or PCs, through integration with third party systems and as a stand alone system.

The complete RADVISION solution is customizable to layer video, voice, and data collaboration onto a customer's network. Key components of the solution include:

- Gateways - Provide videoconferencing interoperability between IP, circuit-switched ISDN and next generation 3G end points and networks.
- Gatekeepers - Control, manage, and monitor real-time voice, video and data traffic over the visual communication networks.
- Conferencing Bridges (or multipoint conferencing units, or MCUs) - Enable voice or multimedia conferencing over packet and ISDN networks among three or more participants.
- Data Collaboration Servers, or DCS - Enable conference participants to collaborate and share applications. The DCS allows users to view diagrams, graphic presentations and slide lectures simultaneously with other videoconferencing participants. It also makes possible text chats, whiteboard exchanges, and rapid file transfers during multipoint videoconferences of three or more participants.
- Pathfinder – A firewall/NAT (network address translation) traversal solution to enable endpoints in different enterprises to communicate with each other across their firewall and NAT devices.

As a result of the FVC acquisition in March 2005, FVC's Click to Meet™, or CTM, product family was added to our NBU portfolio. The CTM solution is designed to address the desktop collaboration market and provides a highly scalable and cost effective solution to PC based video conferencing. The CTM solution provides for scalability to thousands of endpoints within an organization and connectivity to include legacy room systems and hardware endpoint devices into a CTM conference.

- The CTM solution consists of the following components:
- Conference Server – a software based MCU (multipoint conferencing unit) that is highly scalable.
- Conference Manager – a conference management server that registers users and sets up conferences using Microsoft Active Directory services.
- Conference Client – a web-based client that provides the video-collaboration environment on the PC.

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The CTM solution has been integrated into Microsoft's Real-Time Communication family of products, such as Live Meeting and Office Communicator, so that users are using the same Microsoft applications that they are already familiar with, but with the CTM audio/video collaboration embedded.

For carriers, our NBU offers video-based solutions for the services provider market – both IP wireline and more recently broadband wireless. In November 2004, we announced SCOPIA™, our new advanced services platform that enables service providers to offer point-to-point and multipoint real-time video-based services such as video calling and video streaming. Initially targeted to the 3G provider, this carrier-class architecture can also deliver video-based services to residential IP (wireline) customers. Leveraging technologies pioneered by us over two years ago and which can already be found powering 3G networks trials worldwide, SCOPIA is a key component in enabling new revenue-generating video-based services that will complement traditional voice and data services these providers already offer.

Sample services that can be delivered off the SCOPIA platform include:

- Video telephony and conferencing
- PC to mobile video telephony
- Video mail, video messaging
- Multimedia content streaming (television, movies, etc.)
- Video call centers
- Remote surveillance and reporting
- Live entertainment and communications services

The SCOPIA advanced services platform is currently available in two configurations and will ultimately be available in three configurations. The first is the SCOPIA 400, a 4-slot, 2U chassis configuration, which we introduced in November 2004. In the first half of 2005, we also introduced the SCOPIA 1000, a larger 21-slot 12U chassis version of the SCOPIA 400 product, which serves new emerging service provider network architectures and higher density needs in large-scale deployments. The blades used in the SCOPIA 400 and SCOPIA 1000 are interchangeable, thereby providing an easy upgrade path from lower capacity deployments using the SCOPIA 400 to higher capacity deployments using the SCOPIA 1000.

***NBU Product Benefits***

While our products fully support ISDN, we believe that the principal competitive advantage of our family of solutions, for both our enterprise and service provider offerings, is our IP expertise. Our products are among the leading visual communication infrastructure solutions in the industry today by virtue of our technological innovation in five key areas:

*Connectivity.* We believe that our network elements can allow connectivity between any networks – circuit switch, packet IP, or 3G based.

*Simplicity.* We deliver easy to use and easy to operate videoconferencing systems that will connect to any standard video endpoint.

*Distributed Architecture.* We believe that no competing product can match the capacity of the viaIP400. Because of its unique architecture, the viaIP system is not limited to a single chassis. As a result, a single MCU (multipoint conferencing unit) can support up to six gateway boards, achieving a capacity of up to four hundred (400) simultaneous video calls on the same chassis and nearly limitless calls on a stacked multi-chassis system. Additionally, due to the system’s IP architecture, the entire infrastructure does not need to be mounted in a single integrated rack but can be distributed throughout a network. By distributing intelligence throughout the network, the enterprise benefits from increased redundancy, network traffic optimization, resource management, and high scalability. These benefits of huge scalability and distributed architecture are also found in the CTM product portfolio which is designed to support mass deployments in large enterprises.

*Extensive Protocol Support.* In addition to supporting both ISDN and H.323, our solution also supports SIP and 3G-324M – two emerging protocols for desktop and mobile communication.

*Advanced Chips Provide Superior Performance and Functionality at a Lower Cost.* As an IP-centric platform with ISDN support, the RADVISION solution is able to take advantage of the advances in integrated IP multifunction chip technology. The system’s on-board CPU is a PPC 400 MHz. We also use Texas Instrument’s advanced C6x programmable 100 MHz chipset for call functionality.

*IP Protocol Expertise.* We are a leader in developing and delivering advanced voice and video protocols over IP networks, primarily H.323 and SIP. As a result, our solutions support the most recent versions of each of the signal protocols with the associated features they enable. Also, as most IP videoconferencing endpoints in the market use RADVISION protocol stacks, our solutions are interoperable with virtually every standards-based end point on the market today.

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## ***Visual Communication Market Trends Benefiting RADVISION***

*Evolution in the Way People Communicate in the Office.* With the need for greater efficiency and the importance of accurate communication, companies are turning to new ways of communicating to enable remote parties to interact as if they were in the same room. Conference calls and e-mail usage have increased dramatically and Instant Messaging (IM) is being adopted increasingly in the enterprise. This trend to new forms of communication has also sparked enterprises to explore multimedia applications that provide advanced voice, video and data experiences to maximize information flow, whether in a group meeting or person to person.

*Major Vendors Providing Video Telephony and Desktop Multimedia Communications.* 2003 saw the entry of Microsoft into the desktop multimedia communications space with the launch of its Live Communications server and Office Communicator. It also saw Cisco's acquisition of Latitude and its flagship product MeetingPlace. Both of these architectures are for personal (desktop) multimedia conferencing and communications. We believe that due to our unique IP-based architecture and support of standards, such as SIP, our company is in a strong position to provide complementary solutions and/or capitalize on the strong marketing and solution trends that these two large companies, as well as others in the industry, including Nortel with its own desktop solution, are offering to the Information Technology, or IT, manager and chief executive officer, chief information officer and chief technology officer. We have integrated our viaIP/iView product portfolio with Cisco's Video Telephony desktop solution – VT Advantage. During 2005, we also integrated our CTM product portfolio with Microsoft's Real Time Communication suite, including Live Meeting and Office Communicator, as well as with IBM's Sametime desktop product.

*The Spread of Video Telephony beyond the Enterprise and into the Home and on the Road.* End users are beginning to use multimedia applications for their communication not only in the enterprise through meeting rooms and desktops, but also at home and on the road. We are encountering this trend and realizing sales from service providers as they are beginning to use our technology to deliver video telephony services to residential homes as just another broadband application like Internet access and video-on-demand. Additionally, 3G wireless providers are increasingly looking to deliver real-time multimedia content to their mobile subscribers. We believe we are well suited to play a role in this market with our 3G-324M architecture and multimedia services support.

*The Evolution from ISDN to IP.* Traditional (legacy) videoconferencing systems are ISDN-based. This means expensive technology, a separate high-speed line into the office for video only, and a separation between video running over ISDN and data running over IP. However, IP-based videoconferencing recently has been gaining greater acceptance. As companies put voice over their IP networks (VoIP), they are also beginning to put video over their IP networks.

We are the pioneers in videoconferencing over IP. Because our technology is sited in the core of the IP network, our solutions enable network managers to leverage their installed high speed data networks, merge video with voice and data applications (running over the same IP connection) and centrally manage a host of video end points, from meeting room to desktop to PC based systems, and eventually to wireless video phones.

**TECHNOLOGY BUSINESS UNIT**

Our TBU provides standards-based protocol toolkits and testing solutions for the development of real-time voice, video and data communication solutions over packet, 3G and IMS networks.

***TBU Products***

We offer one of the most complete sets of development toolkits for IP and 3G environments. We sell the core enabling technology for real-time IP and 3G-based communication in the form of software development kits. Communication equipment providers and developers seeking to create and market industry standard compliant IP telephony and multimedia products, systems and applications need core IP communication protocol software to develop their IP-centric solutions. The same holds true for developers of 3G-based multimedia solutions.

Developers can use our toolkits to reduce the high costs of in-house continuous investments in order to stay up to date with the rapidly changing and evolving standards and to maintain complete interoperability with different equipment, vendors and service providers. We believe that our toolkits enable customers to focus on their core competencies and reduce the time to market and risk involved with industry standard compliant IP and 3G communication products, systems and applications.

*RADVISION SIP Development Toolkit.* Session Initiation Protocol, commonly referred to as SIP, is a popular signaling protocol for initiating, managing and terminating voice and video sessions across packet networks. SIP was designed for building high performance user agents. The RADVISION SIP Toolkit enables the development of products that require full user/agent functionality. The SIP Toolkit is designed to provide high scalability and extensibility for both small and large-scale projects. It enables the implementation of feature-rich SIP entities such as application servers, softswitches, IP-PBXs, gateways and conferencing bridges. The RADVISION SIP Server Toolkit enables the development of SIP-based infrastructure devices such as IP-PBXs and softswitches. Our SIP is a key milestone for implementing the upcoming IMS network and components. The SIP protocol was also adopted by the 3GPP (3rd Generation Partnership Project) as a mandatory part of the IMS architecture for next generation mobile and fixed networks. The SIP Toolkit supports the needed extensions to cope with the 3GPP requirements in order to provide a solution for IMS applications, services and core-network IMS equipment vendors.

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*RADVISION SIP Server Platform.* The SIP Server Platform provides a complete framework for developing all types of SIP Server applications including Proxies, Redirect Servers, Registrars, Presence Servers, IMS Application Servers and different types of B2BUAs. The SIP Server Platform radically simplifies and accelerates development by providing a standards-compliant, robust and high performance implementation of standard SIP server functionality controlled through a multi-level, user friendly API.

*RADVISION H.323 Development Toolkit.* H.323 is currently the most widely deployed standard for real-time IP communication. All components of an H.323-compliant network, including terminals, gateways, gatekeepers and conferencing bridges, use the H.323 protocol to communicate. The RADVISION H.323 software development kits provide developers with the core software building blocks needed to develop H.323-compliant products, systems and applications. The RADVISION H.323 software development kit is an integrated set of software programs that execute the H.323 protocol and perform the functions necessary to establish and maintain real-time voice, video and data communication over packet-based networks. The RADVISION H.323 software development kits can be used to develop a broad spectrum of products, including gateways, gatekeepers, conferencing bridges, IP telephones and other H.323-compliant products.

*RADVISION MGCP Development Toolkit.* Media gateway control protocol, commonly referred to as MGCP, provides functions that complement H.323 and has been developed for large packet networks operated by telecommunication carriers and service providers that require gateways that can support a high number of calls. MGCP is the protocol by which a centralized gateway controller communicates with and controls the numerous gateways throughout a packet network and manages the network traffic through those gateways. MGCP has been adopted by large telecommunication companies and Internet service providers as well as by cable television companies building IP communication solutions over their networks. The RADVISION MGCP software development kit is used to build MGCP compliant media gateways controllers and media gateways.

*RADVISION MEGACO Development Toolkit.* MEGACO/H.248 is the official industry standard media gateway control protocol for large-scale IP-centric communication networks. Like MGCP, it is an internal protocol used between "intelligent" centralized gateway controllers and numerous "dumb" media gateways that handle voice and video media streams. The standard is the result of a unique collaborative effort between the Internet Engineering Task Force, or IETF, and International Telecommunication Union, or ITU, standards organizations. Derived from MGCP, MEGACO/H.248 offers several key enhancements including support for multimedia and conferencing calls, improved handling of protocol messages and a formal process for creating extensions to support advanced functionality. The RADVISION MEGACO/H.248 Toolkit includes a unique Media Device Manager to greatly simplify application development and reduce development time by eliminating the need for developers to write code for interpreting MEGACO/H.248 messages.

*3G-324M Developer Toolkit.* The IP network has not evolved sufficiently to support high-quality real-time video and voice services over 3G networks. As a result, the 3G standards body, 3GPP, specified the 3G-324M protocol as the signaling and transport mechanism for real-time media over 3G (video streaming, video chat, etc.) 3G-324M routes traffic over the circuit switched network rather than the IP network, enabling the delivery of higher quality services. Because it is circuit-switched based, the standard is well suited for streaming real-time multimedia. 3G-324M enables the development, deployment and support of a wide variety of delay-sensitive applications immediately. These include multimedia conferencing with other 3G mobile end points and wire lined H.323 or SIP terminals, video streaming, cell phone TV, video-on-demand (news, sports, etc.), and multimedia, multi-participant gaming. We were one of the first companies to introduce a toolkit for the development of 3G-324M-based products in early 2003 and we continue to develop improved versions of this solution. We are also active in the ITU (International Telecommunication Union), which is the 3G-324M standardization organization, and chair the 3G-324M worldwide interoperability group within the IMTC (International Multimedia Telecommunications Consortium).

*IP Phone, Integration Access Device (IAD) and Video Phone Frameworks.* In mid-2003, we first introduced a product for the manufacture of IP phones. In mid 2005, we introduced the Video Phone toolkit, designated for videophone and residential gateways developers and manufacturers. The toolkit bundles TBU toolkits along with call control and endpoint management software to provide an IP phone and video phone application for any IP protocol (such as H.323 and SIP). It is now used for the development of a wide variety of applications and devices – from video phones and IP phones to SoHo PBX systems and IP voice gateways. The advanced functionality and broad flexibility in both protocols supported and features enabled makes this toolkit a useful solution for the development of IP communications solutions by our customers.

*RADVISION ProLab Testing Suite.* The RADVISION ProLab™ is designed to simulate and analyze multimedia traffic over a variety of testing scenarios. Based on the RADVISION SIP, H.323 and 3G-324M Protocol Toolkits, this testing tool simulates a full VoIP network with optional 3G cellular support with a professional quality assurance laboratory, enabling developers or QA specialists to test SIP and H.323 and 3G-324M version compliance, version upgrade compliance, stress and load. The RADVISION ProLab Test Manager is a scalable tool designed to be aware of any changes to the SIP and H.323 and 3G-324M standards. It provides the:

- capability to run the same tests on the application each time the underlying protocol version is upgraded;
- flexibility to mix and match scenarios to develop a broad range of testing possibilities; and
- ability to define numerous scripts and scale up the test scenario by linking them as the test plan progresses.

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*Advanced RTP Toolkit.* RADVISION's Advanced RTP/RTCP (Real-Time Transport Protocol/Real-Time Transport Control Protocol) Toolkit is designed to address the requirements of mature, production IP telephony applications. The Toolkit provides enhanced media transport functionality, including support for Security and IPv6 and NAT/Firewall traversal. The Advanced RTP/RTCP Toolkit seamlessly scales from small, embedded platforms up to densely populated parallel processing environments.

*RADVISION RTSP Toolkit.* The RADVISION RTSP (Real Time Streaming Protocol) Toolkit includes a set of intuitive application program interfaces, or APIs, for developing multimedia streaming applications for mobile devices such as personal digital assistants (PDAs) and mobile phones as well as broadband IP-based solutions such as IP TV. Our RTSP Toolkit facilitates faster time-to-market by allowing developers to focus on implementing value-added features instead of the intricacies of the underlying protocols. Our RTSP Toolkit is IETF RFC 2326 bis 4 D.1 compliant.

### ***TBU Product Benefits***

*Market Leading Technology for Standards - Based Real-time IP Communication.* We were one of the original five members of the International Telecommunication Union-Telecommunication committee responsible for defining the H.323 standard, which has been adopted worldwide for real-time packet-based communication. We believe our technology is recognized as the market-leading implementation of the H.323 industry standard for real-time voice, video and data communication over packet networks. We also believe that our technology is recognized as one of the market-leading implementations of the SIP, and other protocols such as 3G-324M and MEGACO/ H.248.

We have been actively involved in the development of protocols for real-time communication since the inception of the industry in 1994 and believe that we were the first-to-market with enabling products and technology for voice, video and data communication over IP networks.

We believe that our technology has become the technology of choice among developers of standards-compliant IP communication systems. We believe our customers benefit from our ability to develop and provide them market-tested, proven products and technology. Using our products and technology, our customers can develop unique capabilities with increased functionality that will differentiate their IP communication solutions in the market. Our products are designed to enable our customers to perform a simple integration using flexible and multi-level APIs. We believe that the accumulated knowledge that we have gained participating in the development of industry standards provides us with a competitive advantage, and positions us to be among the first to market new products and technology based on the latest technological advances.

*Interoperability.* We provide our customers with products and technology that are interoperable across a broad range of IP communication systems. Our products and technology have been integrated into a variety of systems developed by hundreds of communication equipment providers.

This field-proven technology together with our on-going participation in the entire industry's interoperability events leads us to believe that our products and technology are interoperable with all major equipment vendors and products. We believe that our long-standing involvement in the definition of standards and accumulated experience with product development across our broad customer base provides us with a competitive advantage in addressing interoperability needs.

*Multi-domain, Real-time Voice, Video and Data Communication Functionality.* We are one of the few companies that offer IP communication products that support combined voice, video and data communication over IP and 3G networks. We believe that this functionality is attractive to enterprises and service providers that seek a flexible IP communication solution, which can provide enhanced multimedia functionality in fixed line and mobile environments.

*Improved Time to Market.* Our customers rely on our accumulated expertise with communication standards and core technology to significantly reduce their development cycle and improve time to market. Communication equipment providers seeking to market standards-compliant systems for real-time voice and video communication over packet and 3G networks require standards-compliant building blocks to develop their products. Implementing standards as deployable products and technology is a complex task that requires significant technical knowledge and expertise as well as substantial investments of time and resources. Our products and technology enable our customers to shorten their own development time by integrating our proven enabling products and technology into their solutions. Rather than dedicate in-house resources to implementing industry standards, these developers can use our products and technology and focus their core competencies on building enhanced systems, products and applications.

*Broad Range of Product Environments.* Our products and technology provide our customers with flexibility to design individual products and applications or complete systems. Our customers can build a complete network solution for real-time IP communication using our full suite of products or integrate our products with their own products or other vendor products into their real-time IP communication solution. Similarly, our technology has been designed to enable the development of a broad range of products and applications, from those that can service single users, including hand held devices and residential IP phones, to multi-user products, like highly complex, powerful carrier class gateways. Taken together, our products and technology provide all of the key network components necessary to build real-time IP communication solutions.

***Industry Trends That Benefit RADVISION's Developer Toolkits***

*Growth in IP Communications.* In the 1990's, IP communication experienced dramatic growth in traffic. Even during the downturn of 2000 and 2001, IP communications continue to grow. We believe that this trend will continue in the future due to:

- an increasing need for enterprises to expand their networks to enable them to send, access and receive information quickly, economically and globally;

- an increasing use of the Internet and other packet networks for communicating and engaging in commercial transactions;
- an increase in available bandwidth at declining prices;
- the introduction of new voice, video and data communication services and applications;
- the dramatic growth of wireless and broadband mobile networks and the interest by consumers to use WiFi and 3G-based devices and networks for new multimedia services such as video streaming and video telephony;
- the increasing focus by both major vendors, such as Cisco and Microsoft, and IT managers to deploy IP-based multimedia communications to employee desktops; and
- the emergence of low cost, high quality IP communications devices that enable people, both in business and in every day life, to communicate more effectively and access real-time video over broadband mobile or residential IP or 3G connections.
- The growth in complexity of the SIP standard which is making in-house SIP development by potential customers a more difficult task.
- The introduction of the IMS next generation network architecture for both fixed and wireless operators that mandate SIP as its primary signaling protocol. Furthermore, IMS SIP (also known as 3GPP SIP) introduces additional challenges and complexities that were not handled by the IETF SIP.

*Limitations of Traditional Networks.* Traditionally, circuit-switched networks have been the principal medium for the transmission of communication. Circuit-switched technology dedicates a circuit with a fixed amount of bandwidth for the duration of the connection, regardless of a user's actual bandwidth usage. The growth in data communication traffic, particularly the growth in the number of Internet users, has placed significant strains on the capacity of traditional circuit-switched networks. Circuit-switched networks were initially deployed to handle only voice communication and are not well suited for the types of converged multimedia services now seen over IP networks. These networks were not designed to handle data and broadband applications such as video efficiently and cannot scale cost-effectively to accommodate the growth in data traffic.

*Advantages of Packet-based Networks.* While circuit-switched networks were principally designed to handle analog voice traffic, packet-based networks were principally designed for transmitting digital information. Packet-based networks, including IP networks, transmit voice, video and data information in the form of small digital packages called packets. Voice, video and data packets are sent over a single network simultaneously and reassembled at the destination.

Packet switching enables more efficient utilization of available network bandwidth than circuit-switching, allowing more calls to travel through a packet network at the same time. In addition, packet networks are built using open standards, like IP, which promote competition by allowing different vendors to build products and applications that can interoperate with one another. By using packet technologies based on industry standards, new services can be deployed rapidly and economically.

*The Need for Products that Deliver Industry Standards for Real-time IP Communications.* Originally, enterprises and communication service providers deployed packet networks primarily for handling data traffic and not for real-time IP communications. Technical barriers initially hampered the use of packet networks for real-time communication. For example, packet networks were not designed to guarantee the sequential delivery of packets and packets could be lost. In addition, the time of delivery of packets was dependent upon the amount of packet traffic being transmitted over the network. For real-time communication, it is critical that the packets associated with a specific voice or video communication be transmitted in the correct sequence and in a timely manner. Early attempts at real-time IP communication solved these technical problems by using proprietary solutions developed by individual vendors. However, proprietary solutions from different vendors meant that different vendor products could not interoperate with one another.

Our leadership position stems from the pioneering work we began in 1993. We were the first to develop and demonstrate commercially viable technology for establishing real-time voice, video, and data on IP networks. Since our inception, we have been helping to develop the industry standards that are driving the emergence and growth of the use of packet networks for real-time communication. RADVISION was an original member of the ITU (International Telecommunication Union) team that defined the H.323 standard, and we continue to work closely with the ITU, the IETF (Internet Engineering Task Force), IMTC (International Multimedia Telecommunications Consortium), and other industry consortia to define a broad spectrum of IP telephony protocols for voice and video communication including, SIP, MGCP and MEGACO/H.248.

Our protocol toolkits provide the underpinning technology required for the rapid development of next generation products and applications for real-time multimedia communication. Industry giants and emerging technology companies use our family of IP communication protocol toolkits to reduce their time to market for developing interoperable, standards-compliant products, applications and services. Today, our protocols are implemented in a wide range of environments from chipsets to simple user devices like IP phones and video systems through carrier class network devices like gateways, switches and softswitches.

*Growth in Real-time Voice and Video IP Communication.* Due to the inherent benefits of packet networks and the advent of new technologies and standards that have enabled real-time communication over these networks, the use of packet networks for real-time voice, video and data communication is expected to grow dramatically.

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This anticipated growth in real-time IP communication is expected to be driven primarily by enterprises and communication service providers migrating to packet networks. As enterprises move from centralized organizations to distributed networks of employees, customers, suppliers and business partners, they require more effective communication capabilities to support their operations and remain competitive in a global and rapidly changing market. Packet networks are well suited for enterprises because they provide enterprises with the following advantages:

- cost-effective increases in capacity to meet increasing communication traffic demands;
- support for new communication applications, like video conferencing and data collaboration, for improved workforce productivity;
- interoperability with different network configurations of their customers, suppliers and partners; and
- cost savings associated with simplified network management resulting from creating a single network that handles all communication, rather than having to maintain separate telephone and computer networks.

Communication service providers have also begun to deploy packet networks in an effort to compete more effectively in a deregulated market. Global deregulation and rapid technological advances have resulted in the emergence of many new communication service providers, increased competition among traditional telecommunication carriers, lower prices, innovative new product and service offerings and accelerated customer turnover. To remain competitive, communication service providers must be able to develop and introduce new services to differentiate themselves in the market and attract and maintain customers. Packet networks are well suited to accomplish these objectives because they enable the rapid deployment of new and differentiated solutions. In addition, packet-based technology allows new competitors to enter the market quickly without substantial investment in infrastructure.

*Broadband Mobile.* The roll out of 3G (Third Generation) broadband mobile services is moving rapidly in a number of key world markets. While these efforts are proceeding more cautiously in North America, a number of 3G networks in Asia and Europe are already in operation and serving millions of customers.

Both 3G standards bodies, 3GPP and 3GPP2, as well as other standardization organizations envision 3G as running entirely over an IP-based communication network (the Internet). Our products are a key element in implementing this network.

The main problem is that today's IP network (the Internet) is not sufficiently robust for delay sensitive applications and, in fact, will not be so until service providers move to IPv6 and SIP-based IP communication. IP, with its variant transmission delays (many hops routing and congestion effects) and packet overheads, is ill equipped at this time to provide high quality, real time multimedia delivery over 3G (WCDMA and CDMA2000) networks.

While the vision of a true IP-based 3G network has been delayed, the promise of a feature-rich, multimedia wireless experience has not. This is due to the emergence of a standard, called 3G-324M, which addresses and supports the real-time streaming of multimedia broadband wireless communication by routing traffic over the circuit switched network. Being circuit-switched based, the standard has all the hallmarks of a protocol ideal for streaming real-time multimedia, including a fixed delay, low overhead of CODECS, and no IP/UDP/RTP header overheads.

3G-324M, based on ITU H.324M and specified in detail by 3GPP (3GPP TS 26.112 and 3GPP TS 26.111 Working Groups), enables the development, deployment and support of a wide variety of delay-sensitive applications immediately. Enabled applications include multimedia conferencing with other 3G mobile end points, and wire lined H.323 or SIP terminals, video streaming, cell phone TV, video-on-demand (news, sports, etc.) and multimedia, multi-participant gaming.

We have taken a pioneering role in providing 3G-324 developer toolkits (as well as 3G-324M-based infrastructure in our NBU) that enable equipment developers to develop products, ranging from 3G handsets to gateways and media servers, that will deliver real time multimedia services over 3G. Recently, our amendment to the protocol was adopted by the ITU to provide faster call set-up time.

*Professional Services.* In 2003, we launched our Professional Services Division, which assists our customers in developing specialized telecommunications products based on our developer toolkit and reference design solution. This division offers a full range of consulting, engineering and software development services to support our customers in bringing innovative voice and video products to market on time using our suite of developer toolkits and protocol and development expertise. Our Professional Services Division handles the complete project life-cycle from design, throughout the product development, and on-site deployment. In 2005, our Professional Services Division business grew both in the development of IP communications products for clients based on our TBU toolkits and also products that mix our developer expertise/toolkits with multimedia communications infrastructure from our NBU.

**Products and Technology under Development**

We intend to capitalize upon our technological leadership in real-time IP communication and visual communication network appliance and functionality to develop new products and technology that meet the evolving needs of the IP, 3G, and visual communication market. Our future product and technology offerings are expected to include platforms and tools needed for creating value-added IP-centric enhanced services. We have recently added an IMS portfolio that includes both toolkits and testing tools to provide IMS developers with IMS-compliant software infrastructure. We believe that IMS represents the actual standardized evolution of both wireless (3G evolution to IMS) and fixed (next generation, cable) networks into an all-IP network architecture. Accordingly, we view IMS as an opportunity for our company to leverage our technological leadership and business growth.

**Customers**

We generally sell our NBU enterprise products to OEMs, systems integrators and value added resellers, or VARs. Our OEM customers purchase our products to integrate with products that they developed in-house to build complete IP communication solutions. Our systems integrator customers either purchase our full suite of products or integrate our individual products with products of other manufacturers to build complete IP communication solutions. Our VAR customers purchase our products to resell to end-users as separate units, or as part of a family of related product offerings, either under our RADVISION label or under their private label.

We sell our service provider products to major telecom equipment vendors such as Alcatel who take our solution and use it as part of a larger service portfolio.

We sell our TBU products in the form of software development kits directly to developers of IP communication products, systems and applications for developing their own IP communication solutions based on our core enabling technology.

For the years ended December 31, 2004 and 2005, one customer accounted for approximately 27% of our sales.

The following is a representative list of our major customers in 2005:

Aethra Ltd	Glovicom	Northrop Grumman
Alcatel Ltd	GS Plus	NTT
Broadreach	Huawei	Oracle
Cisco	IPC	Presidio
Comneon	Iwatsu	Shenzhen SunLong Communication
Computer Assets	Kelyan Lab	Siemens
Comverse	LG	Sony
Conference Solutions	Logical CMG	Spirent
Counter Trade	Merck & Co.	SVA
ECI	Motorola	Telefonica
Emblaze -Vcon	MSTEL Corporation	TIM
France Telecom	Nortel	

**Sales and Marketing**

*Sales organization.* We market and sell our products through multiple channels in North and South America, Europe, the Middle East and Asia-Pacific. Our networking products are sold to end-users principally through indirect channels by OEMs, system integrators and value added resellers. We market and sell our technology products, primarily in the form of software development kits, directly to developers of IP and 3G communication products and applications.

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We sell to service providers through major telecom equipment vendors such as Alcatel. In several countries in the Asia-Pacific region we sell our software development kits indirectly through local sales representatives.

We currently have sales offices in the United States in New Jersey, California, Maryland, New Hampshire and Texas. We also have a sales office in Israel and marketing or representative/liaison offices in Hong Kong, China, the United Kingdom, France, Germany, Italy, Brazil, Korea, Japan, Singapore, Spain and India. The geographic breakdown of our total sales for the year ended December 31, 2005 was 54% in the Americas, 28% in Europe and the Middle East and 18% in the Asia-Pacific region.

We have dedicated sales teams to support our large strategic accounts as well as to identify potential strategic customers who would deploy our products on large scales and generate significant revenues for us.

*Marketing organization.* Our marketing organization develops strategies and implements programs to support the sale of our products and technology and to sustain and enhance our market position as an industry leader. Our current marketing efforts include various sales and channel support programs designed to drive sales, and marketing communication programs designed to increase industry visibility, including press/analyst tours, trade shows and events, speaking engagements and ongoing interaction with analysts and the media as well as targeted marketing programs. Additional programs include technical seminars where customers and other industry participants are educated in real-time IP communication technology and the benefits of our products and technology. We also view our web site as an important marketing tool for lead generation, customer relations and to support our market position as the communication experts through quality content, including providing information related to issues relevant to the communication industry, as well as important product and market trends.

To reinforce and further strengthen our market position as a technology leader in the field of real-time IP, 3G and visual communication, we actively participate in key industry consortia and standards bodies. We are also active in defining and reviewing evolving IP communication standards that are being developed by international standards bodies including:

- the ITU-T (International Telecommunication Union - Telecommunication), which has published the H.323 and MEGACO standards;
- IETF (Internet Engineering Task Force), which has published the SIP and MEGACO standards;
- CableLabs, an organization of cable operators, which is currently working on defining the MGCP (media gateway control protocol) standard;
- IMTC (International Multimedia Telecommunications Consortium), a global organization to promote interoperable multimedia communication solutions based on international standards;

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- We regularly participate in IMTC-sponsored InterOP (Interoperability) events, a vendor-neutral forum where IMTC members test the interoperability of their products; and
  - 3GPP (3rd Generation Partnership Project), which develops the IMS standards.

### **Customer Care and Support**

Our ability to provide our customers with responsive and qualified customer care and support services globally is essential to attract and retain customers, build brand loyalty and maintain our leadership position in the market. We believe our customer care and support organizational structure enables us to provide superior technical support and customer service on a cost- and time-efficient basis.

We provide global customer care and support for our products and technology. Our customer care and technical support teams are located in Tel Aviv, Israel; Fair Lawn, New Jersey; Bedford, New Hampshire; Sunnyvale, California; Hong Kong and China. We provide a 24 hour, seven day a week, 365 days a year service program in certain of our offices to better serve our networking customers who desire the expanded service. We assist our networking customers with the initial installation, set-up and training. In addition, our technical support team trains and certifies our networking customers to provide local support in each of the geographical areas in which our products are sold.

In addition, customers who purchase our TBU software development kits generally request that we provide them with ongoing engineering and technical support services to integrate our technology into their products, although these services are not essential for the use of our software development kits. Our standard software development kit contract provides for one year of support services, renewable annually at the customer's option. Customers who have contracted for support services receive all relevant software updates and enhancements as well as access to our customer care and technical support teams.

In 2003, we launched our Professional Services Division, which provides development expertise to our TBU customers. We work hand-in-hand with our customers throughout the entire development process, providing a full range of consulting, engineering and software development services to support our customers in bringing innovative voice and video products to market on time using the RADVISION ENSEMBLE suite of developer toolkits and our protocol and development expertise. Our Professional Services Division handles the complete project life-cycle from design, throughout the product development, and on-site deployment. In 2004, our Professional Services Division's effort was expanded to include customized NBU projects for large enterprises and service provider projects.

## Intellectual Property

We rely on copyright, trademark and trade secret laws, confidentiality agreements and other contractual arrangements with our customers, third-party distributors, employees and others to protect our intellectual property.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products and technology or obtain and use information that we regard as proprietary. Policing unauthorized use of our products and technology is difficult. In addition, the laws of some foreign countries in which we currently or may in the future sell products do not protect our proprietary rights to as great an extent as do the laws of the United States. Our means of protecting our proprietary rights may not be adequate and our competitors may independently develop similar technology, duplicate our products or design around our intellectual property.

We rely on certain technology that we license from third parties, including software that is integrated with internally developed software and used in our products to perform key functions. For example, we license T.120 data collaboration software from Data Connection Limited and voice compression technology from Siemens. If we are unable to continue to license any of this software on commercially reasonable terms, we will face delays in releases of our products or will be required to reduce the functionality of our products until equivalent technology can be identified, licensed or developed, and integrated into our current products.

## Competition

We compete in a new, rapidly evolving and highly competitive and fragmented market. We expect competition to intensify in the future. We believe that the main competitive factors in our market are time to market, product quality, features, cost, technological performance, scalability, compliance with industry standards and customer relationships.

The principal competitors in the market for our products currently include:

### Networking Products

- Polycom Networks, a division of Polycom Inc.
- Tandberg
- Codian Ltd.
- Arel

In the 3G market:

- Ericsson
- Dilithium Networks
- NMS Communications

### Software development kits

- Trillium Digital Systems, acquired by Continuous Computing.
- Hughes Software Systems, acquired by Flextronix Software Systems
- Data Connection Limited
- Dilithium Networks
- Netbrics
- Open source developers and In-house developers employed by manufacturers of telecommunication equipment and systems

Additional competitors may enter any of our markets at any time.

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Both Vovida Networks, a subsidiary of Cisco Systems, Inc., and OpenH323 offer H.323 source code for free. In addition, Vovida Networks offers MGCP and SIP source code for free. If our customers choose to use the free source code offered by these organizations instead of purchasing our technology, our revenues from the sale of our software development kits will decline.

### **Manufacturing**

Our manufacturing operations consist of materials planning and procurement, outsourcing of sub-assemblies, final assembly, product assurance testing, quality control and packaging and shipping. We assemble our products in a subcontractor's facilities in Israel and test our products at our facilities in Tel Aviv, Israel. We test our products both during and after the assembly process using internally developed product assurance testing procedures. We have a flexible assembly process that enables us to configure our products at the final assembly stage for customers who require that our products be modified to bear their private label. This flexibility is designed to reduce our assembly cycle time and reduce our need to maintain a large inventory of finished goods. We use an enterprise resource planning, or ERP, system that we purchased from BAAN Systems and modified to our specific needs. This system allows us to use just in time procurement and manufacturing procedures. We believe that the efficiency of our assembly process to date is largely due to our product architecture and our commitment to assembly process design. We manufacture our software development kits on CD-ROMs and package and ship them accompanied by relevant documentation.

As part of our commitment to quality, we have been certified as an ISO 9001:2000 and ISO 4001 supplier. The ISO 9001:2000 and ISO 4001 standards defines the procedures required for the R&D, Customer Support and manufacture of products with predictable and stable performance and quality. We are continuously trying to improve our quality based on the guidelines dictated by the ISO 9001:2000 and ISO 4001 standards.

We currently obtain key components used in the manufacture of certain of our products from a single supplier or from a limited number of suppliers. We do not have long-term supply contracts with our suppliers. Any delays in delivery of or shortages in these components could interrupt and delay manufacturing of our products and result in the cancellation of orders for our products. In addition, these suppliers could discontinue the manufacture or supply of these components at any time. We may not be able to identify and integrate alternative sources of supply in a timely fashion or at all. Any transition to alternate suppliers may result in delays in shipment and increased expenses and may limit our ability to deliver products to our customers. Furthermore, if we are unable to identify an alternative source of supply, we would have to modify our products to use a substitute component, which may cause delays in shipments, increased design and manufacturing costs and increased prices for our products. To date, we have not encountered any material interruptions in supply.

**MANAGEMENT DISCUSSION AND ANALYSIS**

**OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

**OPERATING RESULTS**

*The following discussion of our results of operations should be read together with our consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.*

**Background**

We design, develop and supply products and technology that enable real-time voice, video and data communication over packet networks, including the Internet and other IP networks. We were incorporated in January 1992, commenced operations in October 1992 and commenced sales of our products in the fourth quarter of 1994. Since our initial public offering on March 14, 2000, our ordinary shares have been listed on the NASDAQ National Market (symbol: RVSN) and our ordinary shares have also traded on the Tel Aviv Stock Exchange since October 20, 2002.

Our revenues are generated in U.S. dollars or are linked to the dollar and a majority of our expenses are incurred in U.S. dollars. Consequently, we use the dollar as our functional currency. Transactions and balances in other currencies are re-measured into dollars according to the principles in Financial Accounting Standards Board Statement No. 52. Gains and losses arising from re-measurement are reflected in the statements of operations as financial income or expenses as appropriate.

**Overview**

We are the industry's leading provider of high quality, scalable and easy-to-use products and technologies for videoconferencing, video telephony, and the development of converged voice, video and data over IP and 3G networks. We have approximately 450 customers worldwide including Alcatel, Cisco, Aethra, FastWeb, NTT/DoCoMo, Philips, Panasonic, Samsung, Shanghai Bell, Siemens, Sony and Tandberg. Hundreds of thousands of end-users around the world today communicate over a wide variety of networks using products and solutions based on or built around our multimedia communication platforms and software development solutions.

We have two separate business units, corresponding to our two product lines, to enable our product development and product marketing teams to respond quickly to evolving market needs with new product introductions.

Our Networking Business Unit, or NBU, offers one of the broadest and most complete set of multimedia communication and videoconferencing network solutions for IP, ISDN, H.323, SIP and 3G-based networks, supporting most end points in the industry today. These products are sold primarily to resellers and OEMs who use this infrastructure to develop and install advanced IP and ISDN-based communication systems for enterprise customers. The NBU's Click to Meet™ product line provides a unique highly scalable solution for desktop video collaboration and is sold as an integrated product with common desktop applications. The NBU also provides service providers, both 3G wireless and wireline, with integrated solutions that enable the delivery of converged IP-based multimedia streaming and video telephony applications to corporate customers as a managed service, residential broadband customers, and 3G subscribers worldwide.

Our Technology Business Unit, or TBU, is a one-stop shop of voice and video over IP and 3G Development toolkits. The TBU provides protocol development tools and platforms, as well as associated solutions such as testing platforms and IP phone toolkits that enable equipment vendors and service providers to develop and deploy new IP and 3G-based converged networks, services, and technologies. TBU solutions include developer toolkits for SIP, MEGACO/H.248, MGCP, H.323, and 3G-324M. It also includes our ProLab™ Test Management Suite and IP phone toolkit. Our toolkits have been implemented in a wide range of environments from chipsets to simple user devices like IP phones, and from integrated video systems through carrier class network devices like gateways, switches, soft switches and 3G multimedia gateways.

Both business units also provide professional services to our customers, assisting them to integrate our technology into their products and to customize our products to their specific needs.

**Our Strategy**

Our goal is to be the leading provider of solutions that enable real-time multimedia (voice, video and data) collaboration and communication over packet and 3G networks. We provide solutions at every level - protocol developer toolkits, professional services, network infrastructure, as well as integrated solutions that complement the communication solutions of other vendors such as those from Cisco, Sony, Microsoft and Alcatel. We believe that the combination of offering IP-centric networking products, along with software toolkits, positions us as a key enabling vendor in the evolution of next-generation communications. Both of our product lines are essential for building networks that support real time voice and video communication with full interoperability with legacy ISDN/PSTN networks and technologies. We believe that the opportunities for mass deployment in desktop collaboration and 3G are promising growth levers for our company, complementing our traditional sources of revenues from our TBU and NBU businesses.

**Critical Accounting Policies**

We have identified the following policies as critical to the understanding of our financial statements. The preparation of our financial statements 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 sales and expenses during the reporting periods. Areas where significant judgments are made include, but are not limited to, inventory valuation, intangible assets, warranty, accruals revenue recognition and income tax valuation allowance. Actual results could differ materially from these estimates. Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

*Revenue Recognition.* We account for our revenue in accordance with the provisions of SOP 97-2, "Software Revenue Recognition," issued by the American Institute of Certified Public Accountants and as amended by SOP 98-9 and related interpretations. When an arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met:

- Persuasive evidence of an arrangement exists. We require evidence of an agreement with a customer specifying the terms and conditions of the products or services to be delivered typically in the form of a signed contract or statement of work accompanied by a purchase order.
- Delivery has occurred. For software licenses, delivery takes place when the customer is given access to the software programs via access to a web site or shipped medium. For services, delivery takes place as the services are provided.
- The fee is fixed or determinable. Fees are fixed or determinable if they are not subject to a refund or cancellation and do not have payment terms that exceed our standard payment terms. Typical payment terms are between net 30 days to net 90 days with an average of net 49 days.
- Collection is probable. We perform a credit review of all customers with significant transactions to determine whether a customer is credit worthy and collection is probable.

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In general, revenue for transactions that do not involve software customization or services considered essential to the functionality of the software is recognized as follows: (i) software license fees for sales are recognized upon receipt of license or royalty reports; (ii) all other software license fees are recognized upon delivery of the software; (iii) software maintenance, upgrade protection and technical support are recognized ratably over the contract term; and (iv) consulting, training and other similar services are recognized as the services are performed.

We exercise judgment and use estimates in connection with the determination of the amount of product software license and services revenues to be recognized in each accounting period. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. We record provisions against revenue for estimated sales returns and allowances on product and service-related sales in the same period as the related revenue is recorded. We also record a provision to operating expenses for bad debts resulting from customers' inability to pay for the products or services they have received. These estimates are based on historical sales returns and bad debt expense, analyses of credit memo data, and other known factors, such as bankruptcy. If the historical data we use to calculate these estimates do not accurately reflect future returns or bad debts, adjustments to these reserves may be required that would increase or decrease revenue or net income.

Many of our software arrangements include multiple elements. Such elements typically include any or all of the following: software licenses, software maintenance, technical support and training services. For multiple-element arrangements that do not involve significant modification or customization of the software and do not involve services that are considered essential to the functionality of the software, we allocate value to each element based on its relative fair value, if sufficient specific objective evidence of fair value exists for each element of the arrangement. Specific objective evidence of fair value is determined based on the price charged when each element is sold separately. If sufficient specific objective evidence exists for all undelivered elements, but does not exist for the delivered element, typically the software, then the residual method is used to allocate value to each element. Under the residual method, each undelivered element is allocated value based on specific objective evidence of fair value for that element, as described above, and the remainder of the total arrangement fee is allocated to the delivered element, typically the software. If sufficient specific objective evidence does not exist for all undelivered elements and the arrangement involves rights to unspecified additional software products, all revenue is recognized ratably over the term of the arrangement. If the arrangement does not involve rights to unspecified additional software products, all revenue is initially deferred until typically the only remaining undelivered element is software maintenance or technical support, at which time the entire fee is recognized ratably over the remaining maintenance or support term.

In the case of multiple-element arrangements that involve significant modification or customization of the software or involve services that are considered essential to the functionality of the software, contract accounting is applied according with the provision of SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," in accordance with which revenues are recognized on the percentage of completion basis. The percentage of completion is generally calculated using estimated hours incurred to date relative to the total expected hours for the entire project. The cumulative impact of any revision in estimates to complete or recognition of losses on contracts is reflected in the period in which the changes or losses become known.

The maintenance or support fee is unbundled from the other elements and revenue is recognized ratably over the maintenance or support term.

When specific objective evidence does not exist for software maintenance or support, then all revenue is deferred until completion of the consulting services, at which time the entire fee is recognized ratably over the remaining maintenance or support period.

*Allowances for Doubtful Accounts.* We perform ongoing credit evaluations of our customers' financial condition and we require collateral as deemed necessary. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including the aging of our receivables, historical bad debt experience and the general economic environment. Management applies considerable judgment in assessing the realization of receivables, including assessing the probability of collection and the current credit worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

*Inventories.* Inventories are stated at the lower of cost or market. Cost is determined by the moving average method. We write down obsolete or slow moving inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand, market conditions and sale forecasts. If actual market conditions are less favorable than we anticipate, additional inventory write-downs may be required.

*Warranty Reserves.* Upon shipment of products to our customers, we provide for the estimated cost to repair or replace products that may be returned under warranty. Our warranty period is typically 12 months from the date of shipment to the end user customer. For existing products, the reserve is estimated based on actual historical experience. For new products, the warranty reserve is based on historical experience of similar products until such time as sufficient historical data has been collected on the new product. Factors that may impact our warranty costs in the future include our reliance on our contract manufacturer to provide quality products and the fact that our products are complex and may contain undetected defects, errors or failures in either the hardware or the software.

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*Goodwill and Intangible Assets.* Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. The goodwill on our balance sheet is a result of our acquisitions of the assets of FVC and VisioNex. The identifiable intangible assets, other than goodwill, included in our balance sheet are workforce and patents acquired from FVC and VisioNex. We review goodwill and other intangible assets for potential impairment annually and when events or changes in circumstances indicate the carrying value of the goodwill or the other intangible assets may be impaired, in which case we may obtain an appraisal from an independent valuation firm to determine the amount of impairment, if any. In addition to the possible use of an independent valuation firm, we perform internal valuation analyses and consider other publicly available market information. We determine fair value using widely accepted valuation techniques, including discounted cash flow and market multiple analyses. These types of analyses require us to make assumptions and estimates regarding industry economic factors and the profitability of future business strategies. It is our policy to conduct impairment testing based on our current business strategy in light of present industry and economic conditions, as well as future expectations. In the third quarter of fiscal 2005, we completed our annual impairment testing of goodwill using the methodology described in the notes to the consolidated financial statements, and determined there was no impairment of the VisioNex and FVC goodwill. If actual results are not consistent with our assumptions and estimates, we may be exposed to a goodwill impairment charge.

*Tax Valuation Allowance.* Estimates and judgments are required in the calculation of certain tax liabilities and in the determination of the recoverability of certain of the deferred tax assets, which arise from net operating losses, tax carryforwards and temporary differences between the tax and financial statement recognition of revenue and expense. SFAS No. 109, "Accounting for Income Taxes", also requires that the deferred tax assets be reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized, including the amount of Israel and international pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we use to manage the underlying businesses.

Based on estimates of future taxable profits and losses in certain foreign tax jurisdictions, we determined that a valuation allowance of \$7.1 million was required for specific tax loss carryforwards and other temporary differences as of December 31, 2005. If these estimates prove inaccurate, a change in the valuation allowance could be required in the future.

*Tax contingencies.* Like most companies, domestic and foreign tax authorities periodically audit our income tax returns. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposure associated with our various tax filing positions, including state, foreign and local taxes, we record reserve for probable exposures. A number of years may elapse before a particular matter, for which we have established a reserve, is audited and fully resolved. The estimate of our tax contingency reserve contains uncertainty because management must use judgment to estimate the exposure associated with our various filing positions. Although management believes that the estimates and judgments about the tax contingencies are reasonable, actual results could differ, and we may be exposed to gains or losses that could be material. To the extent we prevail in matters for which reserves have been established, or are required to pay amounts in excess of the reserve, our effective tax rate in a given financial statements period could be materially affected. An unfavorable tax settlement would require use of our cash and result in an increase in our effective tax rate in the year of resolution. A favorable tax settlement would be recognized as a reduction in our effective tax rate in the year of resolution.

*Contingencies.* We are involved in legal proceedings and other claims from time to time. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for any contingencies are made after careful analysis of each individual claim. The required reserves may change due to future developments in each matter or changes in approach, such as a change in the settlement strategy in dealing with any contingencies, which may result in higher net loss. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material. See "Item 8A. Financial Information – Consolidated Statements and Other Financial Information – Legal Proceedings."

## **Revenues**

We generate revenues from sales of our networking products that are primarily sold in the form of stand-alone products, and our technology products that are primarily sold in the form of software development kits, as well as related maintenance and support services. We generally recognize revenues from the sale of our products upon shipment and when collection is probable. Revenues generated from maintenance and support services are deferred and recognized ratably over the period of the term of service. We price our networking products on a per unit basis, and grant discounts based upon unit volumes. We price our software development kits on the basis of a fixed-fee plus royalties from products developed using the software development kits. We sell our products and technology through direct sales and various indirect distribution channels in the Americas, Europe and the Asia-Pacific region. For the year ended December 31, 2005, approximately 54.1% of our revenues were generated in the Americas.

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## Significant Expenses

*Cost of Revenues.* Our cost of revenues consists of component and material costs, direct labor costs, subcontractor fees, overhead related to manufacturing and depreciation of manufacturing equipment. Our gross margin is affected by the selling prices for our products as well as the proportion of our revenues generated from the sale of our technology products as compared to our networking products. Our revenues from the sale of our technology products have higher gross margins than our revenues from the sale of our networking products and we offer greater discounts to our high volume OEM customers. As the relative proportion of our revenues from our networking products increases as a percentage of our total revenues and we generate a higher percentage of our revenues from sales to our high volume OEM customers, our gross margins will decline.

*Research and development expenses.* Our research and development expenses consist primarily of compensation and related costs for research and development personnel, expenses for testing facilities and depreciation of equipment.

Research and development costs are charged to operations as incurred. Software development costs are considered for capitalization when technological feasibility is established according to SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Costs incurred after achievement of technological feasibility in the process of software production have not been material. Therefore, we have not capitalized any of our research and development expenses.

*Marketing and selling expenses.* Our marketing and selling expenses consist primarily of compensation and related costs for sales personnel, marketing personnel, sales commissions, marketing programs, public relations, promotional materials, travel expenses and trade show exhibit expenses.

*General and administrative expenses.* Our general and administrative expenses consist primarily of salaries and related expenses for executive, accounting and human resources personnel, professional fees, provisions for doubtful accounts and other general corporate expenses.

*Financial income, net.* Our financial income consists primarily of interest earned on bank deposits and other liquid investments, gains and losses from the re-measurement of monetary balance sheet items denominated in non-dollar currencies into dollars.

**Recently Issued Accounting Standards**

On December 16, 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 123 (revised 2004), "Share-Based Payment," or SFAS 123(R), which is a revision of SFAS No. 123, "Accounting for Stock Based Compensation," or SFAS 123. Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123.

However, SFAS 123 permitted, but did not require, share-based payments to employees, including employee stock option grants, to be recognized based on their fair values, while SFAS 123(R) requires all share-based payments to employees to be recognized based on their fair values on the date of grant. SFAS 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new standard became effective for us commencing January 1, 2006.

Prior to January 1, 2006, as permitted by SFAS 123, we accounted for share-based payments to employees using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," the intrinsic value method. The impact of adoption of SFAS 123(R) cannot be predicted at this time, as it depends on levels of share-based payments granted in the future. However, had we adopted SFAS 123(R) in 2005, the impact of that standard would have decreased our net income by approximately \$3.7 million, as described in the disclosure of pro forma net income and earnings per share in our consolidated financial statements. In order to mitigate the impact of SFAS 123(R) in 2006, our Board of Directors has resolved to increase the available employee option pool under the 2000 Employee Stock Option Plan by 1.75% of our outstanding shares for 2006, as compared to an increase by 3.3% of our outstanding shares for 2005 (see Item 6E. "Directors, Senior Management and Employees - Share Ownership - Stock Option Plans - 2000 Stock Option Plan").

In March 2005, the Securities and Exchange Commission, or the SEC, released SEC Staff Accounting Bulletin No. 107, "Share Based Payment," or "SAB 107." SAB 107 provides the SEC's staff position regarding the application of SFAS 123(R) and contains interpretive guidance relating to the interaction between SFAS 123(R) and certain SEC rules and regulations, and also provides the SEC staff's view regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosures made relating to the accounting for share-based payment transactions. We are currently reviewing the effect of SAB 107.

## Results of Operations

The following discussion of our results of operations for the years ended December 31, 2003, 2004 and 2005, including the percentage data in the following table, is based upon our statements of income contained in our financial statements for those periods, and the related notes, included in this annual report:

	December 31,		
	2003	2004	2005
Revenues.....	100.0%	100.0%	100.0%
Cost of revenues.....	23.9*	21.6*	17.7
Gross profit.....	76.1	78.4	82.3
Operating expenses:			
Research and development.....	28.4	27.3	27.2
Marketing and selling.....	37.1*	37.1*	33.2
General and administrative.....	7.9	7.6	6.3
Restructuring income.....	(2.1)	-	-
Total operating expenses.....	71.3	72.0	66.7
Operating income.....	4.8	6.4	15.6
Financial income, net.....	4.1	2.9	4.1
Taxes on income.....	-	-	(0.1)
Net income.....	<u>8.9%</u>	<u>9.3%</u>	<u>19.8%</u>

\* Reclassified

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

*Revenues.* Revenues increased by 15.3% from \$64.2 million for the year ended December 31, 2004 to \$74.0 million for the year ended December 31, 2005. This increase was due to a \$3.3 million increase in sales of our technology products and a \$6.5 million increase in sales of our networking products. The increased sales in NBU were derived from our traditional products and sales of our Click to Meet products that we acquired from FVC in March 2005. The results primarily reflect increased sales in the Americas, Asia-Pacific region and Middle East.

Revenues from networking products increased by 14.5% from \$44.8 million for the year ended December 31, 2004 to \$51.3 million for the year ended December 31, 2005. The increase in revenues from networking products was primarily attributable to \$5.1 million revenues from the sales of the Click to Meet products that we acquired from FVC in March 2005.

Revenues from technology products increased by 17.0% from \$19.4 million for the year ended December 31, 2004 to \$22.7 million for the year ended December 31, 2005. The increase in revenues from technology products was attributable to a \$1.4 million increase in software license fees from approximately \$8.3 million in 2004 to approximately \$9.7 million in 2005, a \$0.9 million increase in royalty revenues, and a \$1.5 million increase in maintenance revenues. This was offset in part by a \$0.5 million decrease in professional services with respect to customization services.

Revenue from sales to customers in the North America increased from \$32.6 million, or 50.8% of revenue, for the year ended December 31, 2004, to \$39.4 million, or 53.2% of revenue, for the year ended December 31, 2005, an increase of \$6.8 million, or 20.9%. This increase in sales to customers in the North America was primarily attributable to increased sales to Cisco and due to revenues from the sales of the Click to Meet products that we acquired from FVC in March 2005.

Revenue from sales to customers in Europe and the Middle East increased from \$18.9 million, or 29.4% of revenue, for the year ended December 31, 2004, to \$20.9 million, or 28.2% of revenue, for the year ended December 31, 2005, an increase of \$2.0 million, or 10.6%, mainly due to increased sales to service providers.

Revenue from sales to customers in the Asia-Pacific region increased from \$11.7 million, or 18.2% of revenue, for the year ended December 31, 2004, to \$13.1 million, or 17.6% of revenue, for the year ended December 31, 2005, an increase of \$1.4 million, or 12.0%. This increase in sales to customers in the Asia-Pacific region is primarily attributable to increase in sales in Korea, Japan and Taiwan.

*Cost of Revenues.* Cost of revenues decreased from \$13.9 million for the year ended December 31, 2004 to \$13.1 million for the year ended December 31, 2005, a decrease of \$0.8 million, or 5.8%. Gross profit as a percentage of revenues increased from 78.4% for the year ended December 31, 2004 to 82.3% for the year ended December 31, 2005. The increase in gross profit margin resulted from an increase in revenues volume, sales of Click To Meet products which have higher gross margin, and the product mix.

*Research and Development.* Research and development expenses increased from \$17.5 million for the year ended December 31, 2004 to \$20.1 million for the year ended December 31, 2005, an increase of \$2.6 million, or 14.9%. The increase is primarily attributable to an increase in the number of research and development personnel, mainly to support the acquisition of the Click to Meet products. Research and development expenses as a percentage of revenues remained constant at approximately 27.2% for the years ended December 31, 2004 and 2005.

*Marketing and Selling.* Marketing and selling expenses increased from \$23.8 million for the year ended December 31, 2004 to \$24.6 million for the year ended December 31, 2005, an increase of \$0.8 million, or 3.4%. Marketing and selling expenses as a percentage of revenues decreased from 37.1% for the year ended December 31, 2004 to 33.2% for the year ended December 31, 2005.

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*General and Administrative.* General and administrative expenses decreased from \$4.9 million for the year ended December 31, 2004 to \$4.7 million for the year ended December 31, 2005, a decrease of \$0.2 million, or 4.1%. General and administrative expenses as a percentage of revenues decreased from 7.6% for the year ended December 31, 2004 to 6.3% for the year ended December 31, 2005.

*Financial Income, Net.* Financial income increased from \$1.9 million for the year ended December 31, 2004 to \$3.1 million for the year ended December 31, 2005, principally as a result of higher prevailing interest rates and higher cash and cash equivalent, deposits and marketable securities balances. Financial income in 2005 was principally derived from the investment of the proceeds of our March 2000 initial public offering, cash generated from operating activities and exercise of options by employees.

*Taxes on income.* Income tax benefits were \$0.1 million for the year ended December 31, 2005. The benefit mainly derived from reversing of valuation allowances on deferred income taxes of temporary differences.

### **Year Ended December 31, 2004 Compared with Year Ended December 31, 2003**

*Revenues.* Revenues increased by 25.1% from \$51.3 million for the year ended December 31, 2003 to \$64.2 million for the year ended December 31, 2004. This increase was due to increased sales of both our technology and networking products. Revenues from networking products increased 17.6% from \$38.1 million for the year ended December 31, 2003, to \$44.8 million for the year ended December 31, 2004.

The increase in revenues from networking products was attributable to a \$4.9 million increase in networking products from approximately \$35.3 million in 2003 to approximately \$40.2 million in 2004, and a \$1.8 million increase in maintenance revenues.

Revenues from technology products increased by 47.0% from \$13.2 million for the year ended December 31, 2003 to \$19.4 million for the year ended December 31, 2004. The increase in revenues from technology products was attributable to a \$3.1 million increase in software license fees from approximately \$5.2 million in 2003 to approximately \$8.3 million in 2004, a \$1.4 million increase in royalty revenue, a \$1 million increase in research and development services by our Professional Services Division, which we began to offer in the first quarter of 2003, and a \$700,000 increase in maintenance revenues.

Revenue from sales to customers in North America increased from \$23.7 million, or 46.2% of revenue, for the year ended December 31, 2003, to \$32.6 million, or 50.7% of revenue, for the year ended December 31, 2004, an increase of \$8.9 million, or 37.6%. Revenue from sales to customers in Europe increased from \$11.2 million, or 21.8% of revenue, for the year ended December 31, 2003, to \$15.6 million, or 24.2% of revenue, for the year ended December 31, 2004, an increase of \$4.4 million, or 39.3%. This increase in sales to customers in Europe was primarily attributable to increased market demand for our products and increased sales efforts in Europe. Revenue from sales to customers in the Far East decreased from \$12.7 million, or 24.8% of revenue, for the year ended December 31, 2003, to \$11.7 million, or 18.2% of revenue, for the year ended December 31, 2004, a

decrease of \$1 million, or 7.9%. This decrease in sales was primarily attributable to a decrease in market demand in this region and the reorganization of our sales force in the region. Revenue from sales to customers in Israel increased from \$3.0 million, or 5.8% of revenue, for the year ended December 31, 2003, to \$3.3 million, or 5.1% of revenue, for the year ended December 31, 2004, an increase of \$300,000, or 10.0%. This increase in sales to customers in Israel was primarily attributable to increased sales efforts for our networking products.

*Cost of Revenues.* Cost of revenues increased from \$12.3 million for the year ended December 31, 2003 to \$13.9 million for the year ended December 31, 2004, an increase of \$1.6 million, or 13.0%. Gross profit as a percentage of revenues increased from 76.1% for the year ended December 31, 2003 to 78.4% for the year ended December 31, 2004. The increase in gross profit margin resulted from increase in revenues volume, higher percentage of sales of technology revenues products and mix of networking products.

*Research and Development.* Research and development expenses increased from \$14.6 million for the year ended December 31, 2003 to \$17.5 million for the year ended December 31, 2004, an increase of \$2.9 million, or 19.9%. We hired additional research and development personnel in 2004 consistent with the scope of our research and development programs. Research and development expenses as a percentage of revenues decreased from 28.4% for the year ended December 31, 2003 to 27.3% for the year ended December 31, 2004.

*Marketing and Selling.* Marketing and selling expenses increased from \$19.1 million for the year ended December 31, 2003 to \$23.8 million for the year ended December 31, 2004, an increase of \$4.7 million, or 24.6%. Marketing and selling expenses as a percentage of revenues remain constant at 37.1% for the year ended December 31, 2003 and 2004.

*General and Administrative.* General and administrative expenses increased from \$4.0 million for the year ended December 31, 2003 to \$4.9 million for the year ended December 31, 2004, an increase of \$900,000, or 22.5%. This increase was primarily attributable to an increase in labor and associated costs. General and administrative expenses as a percentage of revenues decreased from 7.9% for the year ended December 31, 2003 to 7.6% for the year ended December 31, 2004.

*Restructuring Income.* As a result of the resolution in February 2004 of the pending litigation relating to our early surrender of an office lease in Paramus, New Jersey we recorded restructuring income of \$1,061,000 in the year ended December 31, 2003. This income represents the surplus of the accruals we had made in prior periods with respect to the litigation. We did not have any restructuring income in the year ended December 31, 2004.

*Financial Income, Net.* Financial income decreased from \$2.1 million for the year ended December 31, 2003 to \$1.9 million for the year ended December 31, 2004, principally as a result of lower interest rates.

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## Consolidated Balance Sheet Data

*Trade Receivables.* Trade receivables increased from \$10.1 million at December 31, 2004 to \$12.3 million at December 31, 2005, an increase of \$2.2 million, or 21.8%. This increase was primarily attributable to the increase in revenues in the fourth quarter of 2005 compared to the fourth quarter of 2004.

*Allowance for Doubtful Accounts.* Allowance for doubtful accounts decreased from \$1.3 million at December 31, 2004 to \$0.7 million at December 31, 2005, a decrease of \$0.6 million or 46.2%. Allowance for doubtful accounts as a percentage of trade receivables decreased from 12.9% as of December 31, 2004 to 5.7% as of December 31, 2005. This decrease is mainly attributable to the write-off of bad debts.

*Other Receivables and Prepaid Expenses.* Other receivables and prepaid expenses increased from \$3.9 million at December 31, 2004 to \$4.3 million at December 31, 2005, an increase of \$0.4 million, or 10.3%. This increase was primarily attributable to advances to suppliers and an increase in deferred tax assets.

*Inventories.* Inventories increased from \$1.2 million at December 31, 2004 to \$2.6 million at December 31, 2005, an increase of \$1.4 million, or 116.7%. The number of inventory days outstanding increased from approximately 32 days at December 31, 2004, to approximately 72 days at December 31, 2005. The increase in inventory level was primarily attributed to expected increase in sales in 2006 mainly as a result of the U.S. federal government contract that we won in late 2005.

*Trade Payables.* Trade payables decreased from \$1.9 million at December 31, 2004 to \$1.8 million at December 31, 2005, a decrease of \$0.1 million, or 5.3%.

*Other Payables, Accrued Expenses and Deferred Revenues.* Other payables, accrued expenses and deferred revenues increased from \$19.5 million at December 31, 2004 to \$20.7 million at December 31, 2005, an increase of \$1.2 million or 6.2%. This increase was primarily attributable to an increase of \$1.0 million in deferred revenues.

## Quarterly Results of Operations

The following tables present consolidated statements of operations data for each of the eight fiscal quarters ended December 31, 2005, in dollars and as a percentage of revenues. In management's opinion, this unaudited information has been prepared on the same basis as our audited consolidated financial statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of the unaudited information for the quarters presented. The results of operations for any quarter are not necessarily indicative of results that we might achieve for any subsequent periods.

	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005	Sept. 30, 2005	Dec. 31, 2005
Revenues .....	\$14,261	\$15,705	\$16,708	\$17,562	\$16,280	\$17,473	\$19,089	\$21,170
Cost of revenues .....	3,285 *	3,575 *	3,630 *	3,390 *	2,776	3,103	3,401	3,830
Gross profit .....	10,976	12,130	13,078	14,172	13,504	14,370	15,688	17,340
Operating expenses:								
Research and development .....	3,780	4,282	4,883	4,539	4,655	5,054	5,171	5,230
Marketing and selling .....	5,649 *	5,950 *	6,101 *	6,148 *	5,757	6,006	6,165	6,660
General and administrative .....	1,240	1,210	1,213	1,237	1,159	1,152	1,165	1,201
Operating income .....	307	688	881	2,248	1,933	2,158	3,187	4,249
Financial income, net .....	412	432	500	516	561	768	774	948
Taxes on income .....	-	-	-	-	-	(30)	(11)	153
Net income .....	\$719	\$1,120	\$1,381	\$2,764	\$2,494	\$2,896	\$3,950	\$5,350
<b>As a percentage of revenues:</b>								
Revenues .....	100 %	100 %	100 %	100 %	100 %	100 %	100 %	100 %
Cost of revenues .....	23	23	22	19	17	18	18	18
Gross profit .....	77	77	78	81	83	82	82	82
Operating expenses:								
Research and development .....	27	27	29	26	29	29	27	25
Marketing and selling .....	40	38	37	35	35	34	32	31
General and administrative .....	8	8	7	7	7	7	6	6
Operating income .....	2	4	5	13	12	12	17	20
Financial income, net .....	3	3	3	3	3	4	4	4
Taxes on income .....	-	-	-	-	-	-	-	1
Net income .....	5 %	7 %	8 %	16 %	15 %	16 %	21 %	25 %

\* Reclassified

We expect our operating results to fluctuate significantly in the future as a result of various factors, many of which are outside our control. Consequently, we believe that period-to-period comparisons of our operating results may not necessarily be meaningful and, as a result, you should not rely on them as an indication of future performance.

### Conditions in Israel

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, and a significant downturn in the economic or financial condition of Israel.

## **Political Conditions**

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 from time to time in intensity and degree, has led to security and economic problems for Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. These developments have adversely affected the regional peace process, placed the Israeli economy under significant stress, and have negatively influenced Israel's relationship with several Arab countries. In August 2005, Israel evacuated all Israeli settlements in the Gaza Strip and four settlements in the West Bank. In August 2005, Israel evacuated all Israeli settlements in the Gaza Strip and four settlements in the West Bank. In January 2006, Hamas won the elections in the Palestinian Authority and on March 28, 2006, elections to the Israeli parliament were held in Israel. The implications of these developments cannot at this time be foreseen. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price.

Furthermore, there are a number of countries that restrict business with Israel or Israeli companies. Restrictive laws or policies of those countries directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

In addition, some of our directors, executive officers and employees in Israel are obligated to annual reserve duty in the Israeli Defense Forces and are may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

To date, no executive officer or key employee has been recruited for military service for any significant time period. Any further deterioration of the hostilities between Israel and the Palestinian Authority into a full-scale conflict might require more significant military reserve service by some of our employees, which may have a material adverse effect on our business.

## **Economic Conditions**

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Although economic activity in Israel has improved recently, our operations could be adversely affected if the economic conditions in Israel begin to deteriorate again.

### Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union Community, known now as the "European Union," concluded a Free Trade Agreement in July 1975 that confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the "EFTA," established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes a redefinition of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and the Asia-Pacific region.

### Impact of Currency Fluctuation and of Inflation

The dollar cost of our operations is influenced by the extent to which any inflation in Israel is offset on a lagging basis, or is not offset by the devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, companies experience increases in the dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability as we receive payment in dollars or dollar-linked NIS for all of our sales while we incur a portion of our expenses, principally salaries and related personnel expenses, in NIS.

The following table presents information about the rate of inflation in Israel, the rate of devaluation of the NIS against the U.S. dollar, and the rate of inflation of Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	Israeli devaluation rate %	Israeli inflation adjusted for devaluation %
2001	1.4	9.3	(7.8)
2002	6.5	7.3	(0.8)
2003	(1.9)	(7.6)	5.8
2004	1.2	(1.6)	2.8
2005	2.4	6.8	(4.3)

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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.

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, with a historically declining trend in the value of the NIS, exchange rate fluctuations and especially larger periodic devaluations 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.

#### **LIQUIDITY AND CAPITAL RESOURCES**

From our inception until our initial public offering in March 2000, we financed our operations through cash generated by operations and a combination of private placements of our share capital and borrowings under lines of credit. We raised a total of approximately \$12.2 million in net proceeds in four private placements prior to our initial public offering. In March 2000, we sold 4,370,000 of our ordinary shares in an initial public offering and 590,822 ordinary shares in a private placement to Samsung Venture Investment Corporation, a member of the Samsung group, and Siemens Aktiengesellschaft. We received net proceeds of \$89.2 million from the public offering and private placement.

As of December 31, 2005, we had approximately \$32.9 million in cash and cash equivalents, \$63.5 million in short term investments and our working capital was approximately \$93.2 million. Taking into account long-term liquid investments, we had approximately \$125.0 million in cash and liquid investments as of December 31, 2005.

Our management believes that another financial measure that is important in assessing our company's financial condition is day's sales outstanding, or DSOs. Our DSOs were 53 days at December 31, 2005 compared to 52 days at December 31, 2004.

Capital expenditures for the years ended December 31, 2003, 2004 and 2005 were approximately \$1.3 million, \$2.3 million and \$2.0 million, respectively. These expenditures were principally for research and development equipment, office furniture and equipment. We invested \$1.3 million in connection with the purchase of the VisionNex assets in May 2004 and \$7.0 million in connection with the purchase of the FVC assets in March 2005. 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 \$14.1 million for the year ended December 31, 2005. This amount was primarily attributable to net income of \$14.7 million, an increase in deferred revenues of \$1.0 million, and depreciation and amortization expenses of \$2.6 million. The increase in cash provided by operating activities was offset in part by increased accounts receivables of \$2.2 million and a \$1.4 million increase of inventories.

Net cash used in investing activities was approximately \$11.0 million for the year ended December 31, 2005. Of the cash used in investing activities in the year ended December 31, 2005, approximately \$7.0 million was used to acquire substantially all of the assets of FVC and its wholly owned subsidiary, CUseeMe Networks, Inc., approximately \$2.0 million, net was used for bank deposits and purchases of marketable securities and approximately \$2.0 million was used for purchases of property and equipment.

On February 28, 2001, we announced that our Board of Directors authorized the repurchase of up to 10% of our outstanding shares in open market transactions at prevailing market prices. We completed the share repurchase program in the first fiscal quarter of 2002, having purchased 1,866,115 ordinary shares at a total cost of \$11.8 million, or an average price of \$6.30 per share.

On August 28, 2002, we announced that our Board of Directors authorized the repurchase of up to \$10 million or 2 million of our ordinary shares in the open market from time to time at prevailing market prices. During April 2003, we started to repurchase our ordinary shares based on the instruction of our Board of Directors. As of December 31, 2003, we had purchased 14,000 ordinary shares at a total cost of \$77,000, or an average price of \$5.5 per share. We did not repurchase any shares in 2004 and 2005. We have reissued all of our purchased ordinary shares in connection with the exercise of employee stock options.

Net cash provided by financing activities was \$9.6 million for the year ended December 31, 2005, compared to \$6.0 million for the year ended December 31, 2004. For both years, cash provided by financing activities was principally attributable to the issuance of ordinary shares for cash upon exercise of options by employees.

As of December 31, 2005, our principal commitments consisted of obligations outstanding under operating leases. Our capital requirements are dependent on many factors, including market acceptance of our products and the allocation of resources to our research and development efforts, as well as our marketing and sales activities. In the last three years, we have experienced substantial increases in our expenditures as a result of the growth in our operations and personnel. We intend to increase our expenditures in the future consistent with our anticipated growth. We anticipate that our cash resources will be used primarily to fund our operating activities, as well as for capital expenditures.

As of December 31, 2005, we had a credit line from a bank in the amount of approximately \$2.5 million, of which approximately \$2.1 million was not utilized and approximately \$0.4 million was utilized in connection with bank guarantees of certain of our agreements and payments.

## **RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES**

We place considerable emphasis on research and development to expand the capabilities of our existing products and technology, to develop new products and to improve our existing technologies and capabilities. We believe that our future success will depend upon our ability to maintain our technological leadership, to enhance our existing products and technology and to introduce on a timely basis new commercially viable products and technology addressing the needs of our customers. Our gross investment in research and development for the years ended December 31, 2003, 2004 and 2005 was \$14.6 million, \$17.5 million and \$20.1 million, respectively. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications.

As of December 31, 2005, our research and development staff consisted of approximately 197 employees compared to 173 as of December 31, 2004. The increase in research and development employees in 2005 was primarily to support the acquisition of FVC's Click to Meet products in March 2005. Our research and development activities are conducted mainly at our facilities in Tel Aviv, Israel and in part in Beijing, China and in New Hampshire, the United States. To introduce new, high quality products, we deploy procedures for the design, development and quality assurance of our new product developments. Our team is divided according to our existing product lines. Each product line team is headed by a team leader and includes software or hardware engineers and quality control technicians.

## **TREND INFORMATION**

Revenues increased by 15.2% to \$74.0 million for the year ended December 31, 2005. This increase was due to increased sales of both our technology and networking products and due to revenues from the Click To Meet products that we acquired from FVC in March 2005. Revenues from networking products increased by 14.5% to \$51.3 million and revenues from technology products increased by 17.0% to \$22.7 million for the year ended December 31, 2005.

## **OFF-BALANCE SHEET ARRANGEMENTS**

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

## EMPLOYEES

As of December 31, 2005, we had 395 employees worldwide, of whom 197 were employed in research and development, 131 in sales and marketing, 32 in management and administration and 35 in operations. Of such employees, 207 were based in Israel, 94 in the Americas, 74 in Hong Kong and China, 16 in the United Kingdom and four in France.

As of December 31, 2004, we had 335 employees worldwide, of whom 175 were employed in research and development, 107 in sales and marketing, 29 in management and administration and 24 in operations. Of such employees, 208 were based in Israel, 54 in the Americas, 60 in Hong Kong and China and 13 in the United Kingdom.

As of December 31, 2003, we had 258 employees worldwide, of whom 114 were employed in research and development, 94 in sales and marketing, 30 in management and administration and 20 in operations. Of such employees, 180 were based in Israel, 53 in the Americas, 18 in Hong Kong and China and seven in the United Kingdom.

Our relationships with our employees in Israel are governed by Israeli labor legislation and regulations, extension orders of the Israeli Ministry of Labor and personal employment agreements. Israeli labor laws and regulations are applicable to all of our employees in Israel. The laws concern various matters, including severance pay rights at termination, notice period for termination, retirement or death, length of workday and workweek, minimum wage, overtime payments and insurance for work-related accidents. We currently fund our ongoing legal severance pay obligations by paying monthly premiums for our employees' insurance policies and or pension funds.

In addition, Israeli law requires Israeli employees and employers to pay specified sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute that include health insurance fees are approximately 16.25% of wages, of which the employee contributes approximately 64.0% and the employer contributes approximately 36.0%. The majority of our permanent employees are covered by life and pension insurance policies providing customary benefits to employees, including retirement and severance benefits. We contribute 13.3% to 15.8%, depending on the employee, of base wages to such plans and the employee contributes about 5.0%. RADVISION and its employees are not parties to any collective bargaining agreements. However, certain 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 Manufacturers' Association of Israel, are applicable to our employees by "extension orders" of the Israeli Ministry of Labor. These provisions principally concern periodic cost of living adjustments, procedures for dismissing employees, travel allowances, recuperation pay and other conditions of employment.

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At the start of their employment, our employees in Israel generally sign written employment agreements that include confidentiality and non-compete provisions. At the start of their employment, our employees in North America generally sign offer letters specifying basic terms and conditions of employment as well as non-disclosure agreements.

## TAXATION

The following is a discussion of Israeli and United States tax consequences material to our shareholders. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not 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 does not exhaust all possible tax considerations.

**You are urged to consult your own tax advisor as to the Israeli, United States and other tax consequences of the purchase, ownership and disposition of our ordinary shares, including, in particular, the effect of any non-Israeli, state or local taxes.**

## ISRAELI TAX CONSIDERATIONS

The following is a summary of the principal Israeli tax laws applicable to us, of the Israeli Government programs from which we benefit and of Israeli foreign exchange regulations. This section also contains a discussion of material Israeli tax consequences to our shareholders who are not residents or citizens of Israel. This summary does not discuss all aspects of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances, or to some types of investors subject to special treatment under Israeli law. Examples of investors subject to special treatment under Israeli law include residents of Israel, traders in securities, or persons who own, directly or indirectly, 10% or more of our outstanding voting capital, all of whom are subject to special tax regimes not covered in this discussion. Some parts of this discussion are based on new tax legislation that has not been subject to judicial or administrative interpretation. The discussion should not be construed as legal or professional tax advice and does not cover all possible tax consequences.

### General Corporate Tax Structure

Israeli companies were generally subject to corporate tax at the rate of 34% of their taxable income in 2005. Pursuant to the Israeli tax reform that came into effect as of January 1, 2003, the corporate tax rate is to undergo staged reductions and will decline to 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

As discussed below, however, the rate is effectively reduced for income derived from an Approved Enterprise.

As of December 31, 2005, our net operating loss carry-forwards for Israeli tax purposes amounted to approximately \$4.8 million. Under Israeli law, these net-operating losses may be carried forward indefinitely and offset against future taxable income. We expect that, during the period in which these tax losses are utilized, our income will be substantially tax-exempt. Therefore, there will be no tax benefit available from these losses and no deferred income taxes have been included in our financial statements. A deferred tax asset relating to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes in the amount of \$200,000 was recorded as of December 31, 2005.

As of December 31, 2005, the net operating loss carry-forwards of our U.S. subsidiary for U.S. tax purposes amounted to approximately \$15.3 million. These losses are available to offset any future U.S. taxable income of our U.S. subsidiary and will expire in the years 2020 through 2025.

### **Tax Benefits under the Law for the Encouragement of Capital Investments, 1959**

Our facilities in Israel have been granted “Approved Enterprise” status under the Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law. The Investment Law provides that capital investments in a production facility (or other eligible assets) may be designated as an Approved Enterprise. Until recently, the designation required advance approval from the Investment Center of the Israel Ministry of Industry, Trade and Labor, or the Investment Center. Each certificate of approval for an Approved Enterprise relates to a specific investment program, delineated both by the financial scope of the investment and by the physical characteristics of the facility or the asset.

A company that owns an Approved Enterprise is eligible for governmental grants, but may elect to receive an alternative package comprised of tax benefits, referred to as the Alternative Track. Under the Alternative Track, a company’s undistributed income derived from an Approved Enterprise is exempt from corporate tax for an initial period (two to ten years, depending on the geographic location of the Approved Enterprise within Israel). The exemption begins in the first year that the company realizes taxable income from the Approved Enterprise.

After expiration of the initial tax exemption period, the company is eligible for a reduced corporate tax rate of 10% to 25% for the following five to eight years, depending on the extent of foreign investment in the company (as shown in the table below). The benefits period is limited to 12 years from completion of the investment under the approved plan or 14 years from the date of the approval, whichever is earlier. A company in which more than 25% of the shareholders are non-residents of Israel, defined under the Investment Law as a Foreign Investors Company, may be eligible for benefits for an extended period of up to ten years.

The tax benefits derived from any certificate of approval relate only to taxable income attributable to the specific Approved Enterprise. To the extent we have more than one approval or only a portion of our capital investments are approved, our effective tax rate will be the result of a weighted combination of the applicable rates.

<b>Percent of Foreign Ownership</b>	<b>Rate of Reduced Tax</b>	<b>Reduced Tax Period</b>	<b>Tax Exemption Period</b>
0-25% .....	25%	5 years	2 years
25-49% .....	25%	8 years	2 years
49-74% .....	20%	8 years	2 years
74-90% .....	15%	8 years	2 years
90-100% .....	10%	8 years	2 years

If a company distributes dividends from tax-exempt Approved Enterprise income, the company will be taxed on the otherwise exempt income at the same reduced corporate tax rate that applies to it after the initial exemption period. Distribution of dividends derived from Approved Enterprise income that was taxed at reduced rates, but not tax exempt, does not result in additional tax consequences to the company. Shareholders who receive dividends derived from Approved Enterprise income are generally taxed at a rate of 15%, which is withheld and paid by the company paying the dividend, if the dividend is distributed during the benefits period or within the following 12 years (but the 12-year limitation does not apply to a Foreign Investors Company).

Currently, we have three Approved Enterprise programs under the Alternative Track of the Investment Law. We have derived, and expect to continue to derive, a substantial portion of our operating income from our Approved Enterprise facilities. We are therefore eligible for a tax exemption for a limited period on undistributed Approved Enterprise income, and an additional subsequent period of reduced corporate tax rates ranging between 10% and 25%, depending on the level of foreign ownership of our shares. The tax benefits attributable to our current Approved Enterprises are scheduled to expire in phases by 2017. We intend to continue to apply for Approved Enterprise programs, but we cannot assure you that we will do so or that we will be successful. We intend to reinvest the entire amount of our tax-exempt income and not to distribute this income as a dividend.

The benefits available to an Approved Enterprise are conditioned upon terms stipulated in the Investment Law and the related regulations (which include making specified investments in property and equipment, and financing a percentage of these investments with share capital), and the criteria set forth in the applicable certificate of approval. If we do not fulfill these conditions in whole or in part, the benefits can be cancelled and we may be required to refund the amount of the benefits, linked to the Israeli consumer price index plus interest. We believe that our Approved Enterprise programs currently operate in compliance with all applicable conditions and criteria, but we cannot assure you that they will continue to do so.

On April 1, 2005, an amendment to the Investment Law came into effect, in which it revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment will qualify for benefits as a "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise). Among other things, the amendment provides tax benefits to both local and foreign investors and simplifies the approval process. The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime will apply only to new investment programs.

As a result of the amendment to the Investment Law, tax-exempt income will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income. We are currently evaluating the impact the amendment will have on us. Based on our preliminary analysis, the April 2005 amendment to the Investment Law, may materially adversely affect our financial statements for the 2006 fiscal year.

**Tax Benefits and Grants for Research and Development**

Israeli tax law allows, under specific conditions, a tax deduction in the year incurred for expenditures, including capital expenditures, 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 from proceeds made available to us through government grants are not deductible according to Israeli law.

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

According to the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which, in a given tax year, determined in Israeli currency (exclusive of income from some 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.

Under the Industry Encouragement Law, Industrial Companies are entitled to the following preferred corporate tax benefits:

- amortization of purchases of acquired technology and patents over an eight-year period for tax purposes;
- amortization of specified expenses incurred in connection with a public issuance of securities over a three-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.

We cannot assure you that we will continue to qualify as an Industrial Company or that the benefits described above will be available to us 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. This law is highly complex. Until December 31, 2005, we measured our Israeli taxable income in accordance with the provisions of this law. Since January 1, 2006, however, we have elected to measure our taxable income based on the changes in the exchange rate of the U.S. dollar rather than on the basis of inflation, and the provisions of this law have not been applicable to us.

### **Taxation of non-Israeli shareholders on receipt of dividends**

Under Israeli tax law, a distribution of dividends from income attributable to an Approved Enterprise will be subject to tax in Israel at the rate of 15%, which is withheld and paid by the company paying the dividend, if the dividend is distributed during the benefits period or within the following 12 years (but the 12-year limitation does not apply to a Foreign Investors Company). Any distribution of dividends from income that is not attributable to an Approved Enterprise will be subject to tax in Israel at the rate of 25%, except that dividends distributed on or after January 1, 2006 to an individual who is deemed "a non-substantial shareholder" will be subject to tax at the rate of 20%.

Under the United States-Israel tax treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a United States resident is 25%. Dividends received by a United States company that holds at least 10% of our voting rights will be subject to withholding tax at the rate of 12.5%, provided certain other conditions in the tax treaty are met (or at the tax rate of 15% in respect of dividends paid from income attributable to our Approved Enterprises).

### **Capital gains taxes applicable to non-Israeli shareholders**

Capital gains from the sale of our ordinary shares by non-Israeli shareholders are exempt from Israeli taxation, provided that the capital gain is not derived from a permanent establishment in Israel. In addition, the United States-Israel tax treaty exempts United States residents who hold less than 10% of our voting rights, and who held less than 10% of our voting rights during the 12 months prior to a sale of their shares, from Israeli capital gains tax in connection with such sale.

## Stamp Tax

Under Israel's Stamp Tax on Documents Law, certain documents are subject to stamp tax. In 2004, the tax authorities began an enforcement campaign involving extensive audits of companies' compliance with the stamp tax obligation with respect to all agreements which had been signed since June 2003. We believe that the applicable provision in our financial statements as of December 31, 2005 is adequate to cover probable liabilities for stamp tax.

Effective January 1, 2006, the Stamp Tax on Documents Law has been cancelled.

## UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- broker-dealers,
- financial institutions,
- certain insurance companies,
- regulated investment companies or real estate investment trusts;
- investors liable for alternative minimum tax,
- tax-exempt organizations,
- non-resident aliens of the U.S. or taxpayers whose functional currency is not the U.S. dollar,
- persons who hold the ordinary shares through partnerships or other pass-through entities,
- persons who acquire their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services,
- investors that actually or constructively own 10% or more of our voting shares, and
- investors holding ordinary shares as part of a straddle or appreciated financial position or a hedging or conversion transaction.

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If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns ordinary shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation. You are urged to consult your tax advisors regarding the foreign and United States federal, state and local tax considerations of an investment in ordinary shares.

For purposes of this summary, a U.S. Holder is:

- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;
- a corporation created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

### **Taxation of Dividends**

The gross amount of any distributions received with respect to ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. You will be required to include this amount of dividends in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in the ordinary shares and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See "-Disposition of Ordinary Shares" below for the discussion on the taxation of capital gains. Dividends will not qualify for the dividends-received deduction generally available to corporations under Section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld there from, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are received. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

Subject to complex limitations, any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. Dividends generally will be treated as foreign-source passive income or, in the case of certain U.S. Holders, financial services income for United States foreign tax credit purposes. U.S. Holders should note that recently enacted legislation eliminates the "financial services income" category with respect to taxable years beginning after December 31, 2006. Under this legislation, the foreign tax credit limitation categories will be limited to "passive category income" and "general category income." Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax, see discussion below. 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 31-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. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, "qualified dividend income" received by a non corporate U.S. Holder in tax years beginning on or before December 31, 2008 will be subject to tax at a reduced maximum tax rate of 15 percent. Distributions taxable as dividends paid on the ordinary shares should qualify for the 15 percent rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel, or the Treaty, or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date.

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The rate reduction also does not apply to dividends received from a company that is currently, or was in the previous year, a passive foreign investment company, see discussion below, or in respect of certain hedged positions or in certain other situations. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

### **Disposition of Ordinary Shares**

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in the ordinary shares. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will be generally allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of ordinary shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such exchange. A U.S. Holder who receives payment in NIS and converts NIS into United States dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to a sale or disposition of ordinary shares, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the Internal Revenue Service, or the IRS. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of such ordinary shares.

### **Passive Foreign Investment Companies**

For U.S. federal income tax purposes, we will be considered a passive foreign investment company, or PFIC, for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) the average percentage of our assets for the taxable year which produce or are held for the production of passive income is at least 50%.

For this purpose, passive income includes generally dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets which produce passive income. If we were determined to be a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. Holders owning ordinary shares. Accordingly, you are urged to consult your tax advisors regarding the application of such rules.

Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC nor do we expect to become a PFIC in the foreseeable future. However, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, there can be no assurances that we will not become a PFIC for any future taxable year.

If we are treated as a PFIC for any taxable year, dividends, to the extent they are considered an "excess distribution", will not be taxed as described above, and gain from the sale or other disposition of ordinary shares that were owned by you during such taxable year will not be treated as capital gain. Rather, unless you elect either to treat your investment in ordinary shares as an investment in a "qualified electing fund", or a QEF election, or to "mark-to-market" your ordinary shares:

- you would be required to allocate income recognized upon receiving certain dividends (an "excess distribution") or gain recognized upon the disposition of ordinary shares ratably over the holding period for such ordinary shares,
- the amount allocated to each year during which we are considered a PFIC and subsequent years, other than the year of the dividend payment or disposition, would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year,
- the amount allocated to the current taxable year and any taxable year before we became a PFIC would be taxable as ordinary income in the current year, and
- you would be required to make an annual return on IRS Form 8621 regarding distributions received with respect to ordinary shares and any gain realized on your ordinary shares.

If you make either a timely QEF election or a timely mark-to-market election in respect of your ordinary shares, you would not be subject to the rules described above. If you make a timely QEF election, you would be required to include in your income for each taxable year your pro rata share of our ordinary earnings as ordinary income and your pro rata share of our net capital gain as long-term capital gain, whether or not such amounts are actually distributed to you. You would not be eligible to make a QEF election unless we comply with certain applicable information reporting requirements. We will provide U.S. Holders with the information needed to report income and gain under a QEF election if we are classified as a PFIC.

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Alternatively, if the ordinary shares are considered “marketable stock” and if you elect to “mark-to-market” your ordinary shares, you will generally include in income, in each year in which we are considered a PFIC, any excess of the fair market value of the ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions would generally be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark to market election is made, is treated as ordinary income or loss (except that loss is treated as capital loss to the extent the loss exceeds the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years). Gain or loss from the disposition of ordinary shares (as to which a “mark-to-market” election was made) in a year in which we are no longer a PFIC, will be treated as a capital gain or loss.

Dividends received by a noncorporate U.S. Holder from a company that is a PFIC either in the year of the distribution or the previous year do not constitute “qualified dividend income” for purposes of the maximum 15% rate discussed above.

### **Backup Withholding and Information Reporting**

Payments in respect of ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and to U.S. backup withholding tax at a rate equal to the fourth lowest income tax rate applicable to individuals, which, under current law, is 28%. Backup withholding will not apply, however, if you (i) are a corporation or fall within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a U.S. Holder’s U.S. tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

Any U.S. Holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional United States information reporting requirements.

**U.S. Gift and Estate Tax**

An individual U.S. Holder of ordinary shares will generally be subject to U.S. gift and estate taxes with respect to ordinary shares in the same manner and to the same extent as with respect to other types of personal property.

**QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS**

We are exposed to a variety of risks, including changes in interest rates and foreign currency fluctuations.

**Interest Rate Risk**

As of December 31, 2005, we had cash and cash equivalents and short-term investments of \$125.0 million. We invest our cash surplus in time deposits, cash deposits, U.S. federal agency securities and corporate bonds with an average credit rating of AA. These investments are not purchased for trading or other speculative purposes. Due to the nature of these investments, we believe that we do not have a material exposure to market risk.

Our exposure to market risks for changes in interest rates is limited since we do not have any material indebtedness.

**Foreign Currency Exchange Risk**

We develop products in Israel and sell them in North America, the Asia-Pacific region and several European countries. As a result our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

Our foreign currency exposure with respect to our sales is mitigated, and we expect it will continue to be mitigated, through salaries, materials and support operations, in which part of these costs are denominated in NIS.

Since the beginning of 2005, the NIS has depreciated approximately 6.8% against the dollar. The depreciation has resulted in a low inflation rate in Israel, which was approximately 2.4% in 2005 compared to an annual inflation rate of 1.2% in 2004.

Since most of our sales are quoted in dollars, and a portion of our expenses are incurred in NIS, our results may be adversely affected by a change in the rate of inflation in Israel or if such change in the rate of inflation is not offset, or is offset on a lagging basis, by a corresponding devaluation of the NIS against the dollar and other foreign currencies.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**RADVISION LTD.**

We have audited the accompanying consolidated balance sheets of RADVISION Ltd. ("the Company") and its subsidiaries as of December 31, 2004 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the accompanying financial statement schedule II, listed in the Index at Item 18. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2004 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Tel-Aviv, Israel  
February 7, 2006

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

**CONSOLIDATED BALANCE SHEETS**

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

	December 31,	
	2004	2005
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 20,206	\$ 32,927
Short-term bank deposits	11,799	17,503
Short-term marketable securities	39,612	46,015
Trade receivables (net of allowance for doubtful accounts of \$ 1,276 and \$ 734 at December 31, 2004 and 2005, respectively)	10,063	12,257
Other accounts receivable and prepaid expenses	3,900	4,318
Inventories	1,220	2,593
<u>Total current assets</u>	<u>86,800</u>	<u>115,613</u>
<b>LONG-TERM INVESTMENTS AND RECEIVABLES:</b>		
Long-term bank deposits	5,384	11,395
Long-term marketable securities	33,365	17,111
Severance pay fund	2,733	2,931
<u>Total long-term investments and receivables</u>	<u>41,482</u>	<u>31,437</u>
<b>PROPERTY AND EQUIPMENT, NET</b>	<u>2,647</u>	<u>3,190</u>
<b>GOODWILL</b>	<u>647</u>	<u>2,966</u>
<b>INTANGIBLE ASSETS, NET</b>	<u>306</u>	<u>3,542</u>
<u>Total assets</u>	<u>\$ 131,882</u>	<u>\$ 156,748</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 1,939	\$ 1,783
Deferred revenues	7,517	8,533
Accrued expenses and other accounts payable	11,949	12,122
<u>Total current liabilities</u>	<u>21,405</u>	<u>22,438</u>
<b>ACCRUED SEVERANCE PAY</b>	<u>3,701</u>	<u>3,643</u>
<u>Total liabilities</u>	<u>25,106</u>	<u>26,081</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Ordinary shares of NIS 0.1 par value:		
Authorized - 25,000,000 shares at December 31, 2004 and 2005; Issued and outstanding - 20,569,018 and 21,803,997 shares at December 31, 2004 and 2005, respectively	196	218
Additional paid-in capital	107,267	116,446
Retained earnings (accumulated deficit)	(687)	14,003
<u>Total shareholders' equity</u>	<u>106,776</u>	<u>130,667</u>
<u>Total liabilities and shareholders' equity</u>	<u>\$ 131,882</u>	<u>\$ 156,748</u>

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

**CONSOLIDATED STATEMENTS OF INCOME**

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

	Year ended December 31,		
	2003	2004	2005
Revenues:			
Products	\$ 35,286	\$ 40,212	\$ 44,548
License and royalties	8,329	13,758	14,486
Services	7,689	10,266	14,978
<u>Total revenues</u>	<u>51,304</u>	<u>64,236</u>	<u>74,012</u>
Cost of revenues:			
Products	10,823	12,009	9,524
Services	*) 1,447	*) 1,871	3,586
<u>Total cost of revenues</u>	<u>12,270</u>	<u>13,880</u>	<u>13,110</u>
Gross profit	39,034	50,356	60,902
Operating costs and expenses:			
Research and development	14,573	17,484	20,110
Selling and marketing	*) 19,050	*) 23,848	24,588
General and administrative	4,040	4,900	4,677
Restructuring income	(1,061)	-	-
<u>Total operating costs and expenses</u>	<u>36,602</u>	<u>46,232</u>	<u>49,375</u>
Operating income	2,432	4,124	11,527
Financial income, net	2,130	1,860	3,051
Income before taxes on income	4,562	5,984	14,578
Taxes on income	-	-	112
Net income	<u>\$ 4,562</u>	<u>\$ 5,984</u>	<u>\$ 14,690</u>
Basic net earnings per Ordinary share	<u>\$ 0.24</u>	<u>\$ 0.30</u>	<u>\$ 0.70</u>
Diluted net earnings per Ordinary share	<u>\$ 0.23</u>	<u>\$ 0.28</u>	<u>\$ 0.66</u>

\*) Reclassified.

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

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

U.S. dollars in thousands, except share data

	Ordinary shares		Additional paid-in capital	Deferred stock compensation	Treasury stock	Retained earnings (accumulated deficit)	Total shareholders' equity
	Number	Amount					
Balance as of January 1, 2003	18,285,930	\$ 187	\$ 104,586	\$ (117)	\$ (11,757)	\$ (7,884)	\$ 85,015
Purchase of treasury stock	(14,000)	-	-	-	(77)	-	(77)
Exercise of share options by employees	1,072,919	-	77	-	6,759	(2,151)	4,685
Amortization of deferred stock compensation	-	-	-	117	-	-	117
Net income	-	-	-	-	-	4,562	4,562
Balance as of December 31, 2003	19,344,849	187	104,663	-	(5,075)	(5,473)	94,302
Exercise of share options by employees	1,224,169	9	2,604	-	5,075	(1,198)	6,490
Net income	-	-	-	-	-	5,984	5,984
Balance as of December 31, 2004	20,569,018	196	107,267	-	-	(687)	106,776
Tax benefit related to exercise of stock options	-	-	24	-	-	-	24
Exercise of share options by employees	1,234,979	22	9,155	-	-	-	9,177
Net income	-	-	-	-	-	14,690	14,690
Balance as of December 31, 2005	21,803,997	218	\$ 116,446	\$ -	\$ -	\$ 14,003	\$ 130,667

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

U.S. dollars in thousands

	Year ended December 31,		
	2003	2004	2005
<u>Cash flows from operating activities:</u>			
Net income	\$ 4,562	\$ 5,984	\$ 14,690
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,926	2,513	2,589
Loss (gain) on sale of property and equipment	(45)	75	(14)
Restructuring income	(1,061)	-	-
Accrued interest and amortization of premium on held-to-maturity marketable securities and bank deposits	998	1,589	228
Amortization of deferred stock compensation	117	-	-
Decrease (increase) in trade receivables, net	820	(1,378)	(2,194)
Decrease (increase) in other accounts receivable and prepaid expenses	124	(729)	(60)
Decrease (increase) in inventories	27	(251)	(1,373)
Increase in deferred tax asset	-	-	(203)
Increase (decrease) in trade payables	(2,077)	669	(156)
Increase in deferred revenues	3,184	1,470	966
Increase (decrease) in accrued expenses and other accounts payable	716	(91)	(127)
Tax benefit related to exercise of stock options	-	-	24
Decrease in accrued severance pay	(238)	(214)	(256)
Net cash provided by operating activities	<u>9,053</u>	<u>9,637</u>	<u>14,114</u>
<u>Cash flows from investing activities:</u>			
Proceeds from redemption of held-to-maturity marketable securities	56,811	35,240	42,330
Purchase of held-to-maturity marketable securities	(75,111)	(43,630)	(32,939)
Proceeds from withdrawal of bank deposits	18,476	17,121	23,179
Purchase of bank deposits	(10,119)	(17,002)	(34,662)
Purchase of property and equipment	(1,300)	(2,319)	(1,956)
Proceeds from sale of property and equipment	182	23	19
Purchase of FVC's assets, net (1a)	-	-	(7,001)
Purchase of VisioNex's assets, net (1b)	-	(1,320)	-
Net cash used in investing activities	<u>(11,061)</u>	<u>(11,887)</u>	<u>(11,030)</u>
<u>Cash flows from financing activities:</u>			
Exercise of share options by employees	-	2,621	9,637
Purchase of treasury stock	(77)	-	-
Issuance of Ordinary shares and treasury stock for cash upon exercise of options	4,693	3,402	-
Net cash provided by financing activities	<u>4,616</u>	<u>6,023</u>	<u>9,637</u>
Increase in cash and cash equivalents	2,608	3,773	12,721
Cash and cash equivalents at the beginning of the year	13,825	16,433	20,206
Cash and cash equivalents at the end of the year	<u>\$ 16,433</u>	<u>\$ 20,206</u>	<u>\$ 32,927</u>
<u>Supplemental disclosure of non-cash activity:</u>			
Receivables on account of shares	<u>\$ 8</u>	<u>\$ 475</u>	<u>\$ 15</u>

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

U.S. dollars in thousands

(1) Supplemental disclosure of cash flow information:

- a. In March 2005, the Company acquired the assets and the business of First Virtual Communication Inc. ("FVC"). The net fair value of the assets acquired and the liabilities assumed at the date of acquisition was as follows:

Working capital, excluding cash and cash equivalents	\$ 265
Property and equipment	57
Technology	3,285
Distribution network	1,075
Goodwill	2,319
	<u>7,001</u>
	<u>\$ 7,001</u>

- b. In July 2004, the Company acquired the assets and the business of VisioNex Technologies Inc. ("VisioNex"). The net fair value of the assets acquired was as follows:

Technology	\$ 673
Goodwill	647
	<u>1,320</u>
	<u>\$ 1,320</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 1:- GENERAL**

- a. RADVISION Ltd. ("the Company") is an Israeli corporation which designs, develops and supplies products and technology that enable real-time voice, video and data communications over packet networks, including the Internet and other networks based on the Internet Protocol ("IP").

The Company's products and technology are used by its customers to develop systems that enable enterprises and service providers to use packet networks for real-time IP communications.

The Company operates under two reportable segments: 1) the Networking Business Unit (or "NBU"), which focuses on networking solutions and products and is responsible for developing networking products for IP-centric voice, video and data conferencing services; and 2) the Technology Business Unit ("TBU"), which focuses on creating developer toolkits for the underlying IP communication protocols and testing tools needed for real-time voice and video over IP.

The Company has seven wholly-owned subsidiaries: RADVISION Inc. in the United States, RADVISION HK in Hong Kong, RADVISION U.K. in the United Kingdom, RADVISION Japan KK in Japan, RADVISION FRANCE in France, RADVISION B.V., in the Netherlands all are primarily engaged in marketing the Company's products and technology, and RADVISION Communication Development (Beijing) Co. Ltd. in China. (see Note 1c), which is primarily engaged in research and development.

- b. Acquisition of assets and the business of First Virtual Communication Inc ("FVC"):

Following a bidding process held under the supervision of a United States Bankruptcy Court, the Company acquired substantially all of the assets of FVC and its wholly-owned subsidiary, CUseeMe Networks, Inc. on March 15, 2005. FVC creates leading software products that enable interactive voice, video and data collaboration over IP-based networks. The cash purchase price for the acquisition, including transaction costs, was \$ 7,496.

The acquisition was accounted for under the purchase method of accounting, in accordance with SFAS No. 141, and accordingly, the purchase price was allocated to the assets acquired and the liabilities assumed based on their estimated fair value at the date of acquisition and the results of FVC's operations were included in the consolidated financial statements commencing from the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired was recorded as goodwill. The purchase price of the acquisition was determined and paid based on significant consideration for synergistic and strategic benefits.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 1:- GENERAL (Cont.)**

Based upon a valuation of tangible and intangible assets acquired, the Company has allocated the total cost of the acquisition to FVC's net assets as follows:

Tangible assets acquired (including cash and cash equivalents)	\$ 1,167
Liabilities assumed	(350)
Intangible assets:	
Technology	3,285
Distribution networks	1,075
Goodwill	<u>2,319</u>
Total consideration	<u>\$ 7,496</u>

Amortization of acquired technology and distribution networks is calculated using estimated useful lives of 4 years.

Goodwill of \$ 2,319 represents the excess of the purchase price over the fair market value of the net tangible and intangible assets acquired. Goodwill will not be amortized and will be tested for impairment at least annually. The acquired goodwill is allocated to NBU segment.

c. Acquisition of assets and the business of VisionNex Technologies Inc.:

In May 2004, the Company entered into an asset purchase agreement with VisionNex Technologies Inc. ("VisionNex"), a U.S. based company with a wholly-owned Chinese subsidiary.

In July 2004, the Company incorporated a wholly-owned subsidiary under the laws of China, RADVISION Communication Development (Beijing) Co. Ltd., for the purpose of operating a research and development center in China.

The assets purchased by the Company consisted of the technology and workforce used by VisionNex in conducting its business. The consideration for the assets purchased from VisionNex amounted to \$ 1,320. For the useful life of intangible asset - see Note 6. In addition, the Company hired certain former employees of VisionNex.

The transaction was accounted for under the purchase method of accounting. The purchase price was allocated to the technology with the residual recognized as goodwill. The pro-forma effect of the acquisition is immaterial to the Company's results.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands**

**NOTE 1:- GENERAL (Cont.)**

Based upon a valuation of tangible and intangible assets acquired, the Company has allocated the total cost of the acquisition to VisionNex net assets as follows:

Technology	\$ 673
Goodwill	<u>647</u>
	<u>\$ 1,320</u>

Goodwill of \$ 647 represents the excess of the purchase price over the fair market value of intangible assets acquired. Goodwill will not be amortized and will be tested for impairment at least annually. The acquired goodwill is allocated to NBU segment.

- d. Revenues derived from the Company's largest customer in 2005, represented 26.5% of total sales (see Note 12e).

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements are prepared according to accounting principles generally accepted in the United States ("U.S. GAAP").

- a. Use of estimates:

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

- b. Financial statements in U.S. dollars:

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

Accordingly, the Company's and its subsidiaries' transactions and balances denominated in dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured into dollars in accordance with Statement of the Financial Accounting Standard No. 52, "Foreign Currency Translation" ("SFAS No. 52"). Amounts in currencies other than U.S dollars have been remeasured as follows:

- Monetary balances - at the exchange rate in effect on the balance sheet date.
- Revenues and costs - at the exchange rates in effect as of the date of the transactions.

All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of income under financial income, net.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated upon consolidation.

## d. Cash equivalents:

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

## e. Marketable securities:

The Company accounts for investments in debt securities in accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held-to-maturity since the Company has the positive intent and ability to hold the securities to maturity. These securities are stated at amortized cost and are therefore adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization, accretion and interest on the debt securities are included in financial income, net.

## f. Short-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The deposits are in dollars and bear interest at an annual average rate of 3.68% at December 31, 2005. The short-term deposits are presented at their cost, including accrued interest.

## g. Long-term bank deposits:

Long-term bank deposits are deposits with maturities of more than one year. These deposits are presented at their cost plus accrued interest. The deposits are in dollars and bear interest at an annual average rate of 4.36% at December 31, 2005. These deposits mature in 2006 and in 2007. The long-term deposits are presented at their cost, including accrued interest.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Inventories:

Inventories are stated at the lower of cost or market value.

Cost is determined as follows:

Raw materials - using the average cost method.

Finished products - raw materials as mentioned above and subcontractors' costs on an average basis.

Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence. The Company periodically evaluates the quantities on hand relative to historical and projected sales volume and the age of the inventory. Based on this evaluation, provisions are made when required to write inventory down in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand, market conditions and sale forecast. The Company's provision for slow-moving items or technological obsolescence was \$ 1,505 and \$ 895 as of December 31, 2004 and 2005, respectively.

i. Property and equipment:

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

	%
Computers and peripheral equipment	15 - 33
Office furniture and equipment	7 - 15
Motor vehicles	15
Leasehold improvements	Over the shorter of the term of the lease or useful lives

j. Goodwill and Intangible assets:

Goodwill reflects the excess of the purchase price of business acquired over the fair value of net assets acquired. Intangible assets consist mainly of acquired technology, trade names and customer relations.

Effective January 1, 2002, the Company adopted the full provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets ("SFAS No. 142"). Under SFAS No. 142, goodwill is no longer amortized but instead is tested for impairment at least annually (or more frequently if impairment indicators arise).

SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment while the second phase (if necessary) measures impairment.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. As of December 31, 2005, no instances of impairment were found.

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. The Company amortizes its intangible assets on a straight line basis.

k. Impairment of long-lived assets:

The Company's and the subsidiaries' long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment exists when the carrying value of the asset exceeds the aggregate undiscounted cash flows expected to be generated by the asset. The impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2005, no impairment indicators have been identified.

l. Severance pay:

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

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

Severance pay expenses for the years ended December 31, 2003, 2004 and 2005 amounted to approximately \$ 482, \$ 590 and \$ 659, respectively.

m. Revenue recognition:

The Company and its subsidiaries generate revenues mainly from: 1) sales of systems; 2) licensing the rights to use their software products and royalty income; 3) maintenance and support and 4) customization projects. The Company and its subsidiaries sell their hardware products through OEMs, system integrators and value added resellers, all of whom are considered end-users.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Software licensing, royalties and sales of systems revenues:

The Company accounts for its product sales in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"). SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair value of the elements. However, the Company has adopted Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions" ("SOP 98-9"). According to SOP No. 98-9, revenues should be allocated to the different elements in the arrangement under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the residual method, at the outset of the arrangement with the customer, the Company defers revenue for the fair value of its undelivered elements (maintenance and support) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (software product) when all other criteria in SOP 97-2 have been met. Any discount in the arrangement is allocated to the delivered element.

Revenue from license fees and sales of systems is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement.

The VSOE of fair value of the maintenance and support services is determined based on the price charged when sold separately or when renewed.

Certain royalty agreements provide for per unit royalties to be paid to the Company based on the shipments by customers of units containing the Company's products. Revenues under such agreements are recognized at the time of shipment by customers as they are reported to the Company by these customers and when collectability is probable.

Revenues from software licenses and or sale of system that require significant customization, integration and installation are recognized based on SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts", according to which revenues are recognized on a percentage of completion basis. Percentage of completion is determined based on the "Output Method", upon completion of milestones, when collectibility is probable. After delivery of milestone, if uncertainty exists about customer acceptance, revenue is not recognized until acceptance. Provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of the losses is identified. As of December 31, 2005, no such estimated losses were identified.

Deferred revenue includes unearned amounts received under maintenance and support contracts, and amounts received from customers but not recognized as revenues.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company offers a one-year warranty on all of its products. The specific terms and conditions of those warranties vary depending upon the product sold and country in which the Company does business. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The Company and its subsidiaries generally do not grant a right of return to their customers. When returns are expected and estimated, the Company records a provision for product returns at the time product revenues is recognized; based on its experience, in accordance with Statement of Financial Accounting Standard No. 48, "Revenue Recognition When Right of Return Exists". The provision has been deducted from revenues and amounted to \$ 17 and \$ 66 for the years ended December 31, 2003 and 2004, respectively and \$ 79 added to revenue for the year ended December 31, 2005.

**Customer incentives:**

The Company records reductions to revenue and trade receivables for volume-based incentives, at the time revenue is recorded, based on the estimated amount of incentives earned. Marketing development programs, when granted, are recorded as an addition to marketing expense, according to the provisions of EITF 01-9 "Accounting for a consideration given by vendor to a customer including a reseller of the vendor's products". As of December 31, 2004 and 2005, the Company deferred an amount of \$310 and \$368, respectively, due to the abovementioned incentives.

**n. Research and development costs:**

Research and development costs are charged to the statement of income as incurred. Statement of Financial Accounting Standard No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working models and the point at which the products are ready for general release have been insignificant. Therefore, all research and development costs have been expensed.

**o. Royalty-bearing grants:**

The Company received grants from the Israel U.S Binational Industrial Research and Development Foundation (see Note 9a). These grants are recognized at the time the Company is entitled to such grants on the basis of the costs incurred and included as a deduction of research and development costs.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## p. Income taxes:

Income taxes are accounted for in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This Statement prescribes the use of the liability method whereby deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax bases of assets and liabilities and for carryforward losses. Deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

## q. Fair value of financial instruments:

The carrying amounts reported in the balance sheet for cash and cash equivalents, short-term bank deposits, trade and other receivables and trade and other payables approximate their fair values due to the short-term maturities of such instruments.

The fair value of held-to-maturity marketable securities is based on quoted market prices and it does not differ significantly from its carrying amount (see Note 3).

The fair value of long-term bank deposits approximates its carrying amount since the deposits bear interest at a rate approximating the market rate.

## r. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and FASB interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock options. According to APB No. 25, compensation expense is measured under the intrinsic value method, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price at the grant date of the award.

The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"), which amended certain provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Company's net income and net earnings per share is required by SFAS No. 123 as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The fair value of these options is amortized over their vesting period and estimated at the date of grant using a Black-Scholes multiple option pricing model with the following weighted average assumptions; risk-free interest rates of 2.37%, 3.41% and 4.05% for 2003, 2004 and 2005, respectively; a dividend yield of 0.0% for each of those years; a volatility factor of the expected market price of the Company's Ordinary shares of 0.77 for 2003, 0.42 for 2004 and 0.38 for 2005; and a weighted-average expected life of the option of 4 years for 2003, 2004 and 2005.

For pro forma purposes, compensation expenses are amortized on a straight line basis.

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

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Net income as reported	\$ 4,562	\$ 5,984	\$ 14,690
Add: stock based compensation expense determined under APB 25 intrinsic value	117	-	-
Deduct: stock-based compensation expense determined under fair value method for all awards	(3,640)	(3,588)	(3,687)
Pro forma income	<u>\$ 1,039</u>	<u>\$ 2,396</u>	<u>\$ 11,003</u>
Basic net earnings per Ordinary share, as reported	<u>\$ 0.24</u>	<u>\$ 0.30</u>	<u>\$ 0.70</u>
Pro forma basic net earnings per Ordinary share	<u>\$ 0.06</u>	<u>\$ 0.12</u>	<u>\$ 0.52</u>
Diluted net earnings per Ordinary share as reported	<u>\$ 0.23</u>	<u>\$ 0.28</u>	<u>\$ 0.66</u>
Pro forma diluted net earnings per Ordinary share	<u>\$ 0.05</u>	<u>\$ 0.11</u>	<u>\$ 0.50</u>
Weighted average number of shares used to compute pro forma basic net earnings per Ordinary share	<u>18,660,444</u>	<u>19,822,061</u>	<u>21,121,908</u>
Weighted average number of shares used to compute pro forma diluted net earnings per Ordinary share	<u>19,338,692</u>	<u>20,941,474</u>	<u>21,850,643</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## s. Concentration of credit risk:

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

The majority of the Company's cash and cash equivalents, short-term and long-term bank deposits are invested in dollar investments with major banks in Israel and the United States. Such cash and cash equivalents, short-term and long-term bank deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. However, management believes that the financial institutions that hold the Company's investments are financially sound and accordingly, minimal credit risk exists with respect to these investments.

The marketable securities of the Company and its subsidiaries include investments in debentures of U.S corporations, and state and political subdivisions. Management believes that the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

The trade receivables of the Company and its subsidiaries related to the NBU business are derived from sales to large and solid organizations located mainly in North America, Europe, the Far East and Israel. The Company and its subsidiaries perform ongoing credit evaluations of their customers and to date have not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company and its subsidiaries have determined to be doubtful of collection. In certain circumstances, the Company and its subsidiaries may require letters of credit, other collateral or additional guarantees.

The Company and its subsidiaries' trade receivables related to the TBU business are derived from sales to emerging companies located mainly in North America, Europe, the Far East and Israel. The Company and its subsidiaries perform ongoing credit evaluations of their customers and record an allowance for doubtful accounts with respect to those amounts that were determined to be doubtful of collection. When uncertainty of collectibility exists, the Company and its subsidiaries defer revenues until such uncertainty expires.

The Company and its subsidiaries do not have any significant off-balance-sheet concentration of credit risk, such as foreign exchange contracts, options contracts or other foreign hedging arrangements.

## t. Basic net earnings per share:

Basic net earnings per share is computed based on the weighted average number of Ordinary shares outstanding during the year. Diluted net earnings per share further includes the effect of dilutive stock options outstanding during the year, all in accordance with SFAS No. 128, "Earnings Per Share".

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Options outstanding to purchase approximately 1,202,258, 947,949 and 342,186 Ordinary shares for the years ended December 31, 2003, 2004 and 2005, respectively, were not included in the computation of diluted net earnings per share, because option exercise prices were greater than the average market price of the Ordinary shares and therefore their inclusion would have been anti-dilutive.

u. Reclassification:

Certain reclassifications were made in prior years' financial statements to conform to the current presentation

v. New accounting pronouncements:

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), "Share-Based Payment" ("Statement 123(R)", which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". Statement 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

The Company expects to adopt Statement 123(R) on the first interim period beginning after January 1, 2006. Statement 123(R) permits public companies to adopt its requirements using one of two methods:

- a) A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.
- b) A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company plans to adopt Statement 123(R) using the modified-prospective method.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

As permitted by Statement 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method will have a significant impact on the Company's results of operations, although it will have no impact on the Company's overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma income and earnings per share in r above.

In March 2005, the SEC released SEC Staff Accounting Bulletin No. 107, "Share Based Payment" ("SAB 107"). SAB 107 provides the SEC's staff position regarding the application of FAS 123(R) and contains interpretive guidance relating to the interaction between FAS 123(R) and certain SEC rules and regulations, and also provides the SEC staff's view regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosures made relating to the accounting for share-based payment transactions. The Company is currently reviewing the effect of SAB 107;

**NOTE 3:- MARKETABLE SECURITIES**

The following is a summary of held-to-maturity securities at December 31, 2004 and 2005:

	Amortized cost		Unrealized losses, net		Estimated fair value	
	2004	2005	2004	2005	2004	2005
Due in one year or less						
Debts of states and political subdivisions	\$ 24,334	\$ 32,803	\$ (106)	\$ (1,308)	\$ 24,228	\$ 31,495
Corporate debentures	15,278	13,212	(160)	801	15,118	14,013
	<u>39,612</u>	<u>46,015</u>	<u>(266)</u>	<u>(507)</u>	<u>39,346</u>	<u>45,508</u>
Due after one year through two years						
Debts of states and political subdivisions	27,405	12,511	(215)	749	27,190	13,260
Corporate debentures	5,960	4,600	(180)	(961)	5,780	3,639
	<u>33,365</u>	<u>17,111</u>	<u>(395)</u>	<u>(212)</u>	<u>32,970</u>	<u>16,899</u>
	<u>\$ 72,977</u>	<u>\$ 63,126</u>	<u>\$ (661)</u>	<u>\$ (719)</u>	<u>\$ 72,316</u>	<u>\$ 62,407</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 3:- MARKETABLE SECURITIES (Cont.)**

The unrealized losses in the Company's investments in debts of states and political subdivisions and corporate debentures were caused by interest rate increases. It is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Based on Company's intention to hold these investments until maturity, the bonds were not considered to be other than temporarily impaired at December 31, 2005.

**NOTE 4:- INVENTORIES**

Inventories are composed of the following:

	December 31,	
	2004	2005
Raw materials	\$ 1,091	\$ 2,451
Finished products	129	142
	<u>\$ 1,220</u>	<u>\$ 2,593</u>

**NOTE 5:- PROPERTY AND EQUIPMENT**

Composition of assets, grouped by major classifications, is as follows:

	December 31,	
	2004	2005
Cost:		
Computers and peripheral equipment	\$ 9,970	\$ 11,628
Office furniture and equipment	2,612	2,836
Motor vehicles	152	111
Leasehold improvements	1,850	1,979
	<u>14,584</u>	<u>16,554</u>
Less - accumulated depreciation	11,937	13,364
Depreciated cost	<u>\$ 2,647</u>	<u>\$ 3,190</u>

Depreciation expenses for the years ended December 31, 2003, 2004 and 2005 amounted to \$ 1,926, \$ 2,146 and \$ 1,465, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 6:- INTANGIBLE ASSETS, NET**

- a. The following table shows the Company's intangible assets for the periods presented:

	December 31,	
	2004	2005
Cost:		
Technology	\$ 673	\$ 3,958
Distribution networks	-	1,075
	673	5,033
Less - accumulated amortization	367	1,491
Amortized cost	<u>\$ 306</u>	<u>\$ 3,542</u>

Intangible assets resulted from acquisitions of VisionNex (see Note 1c), and FVC (see Note 1b).

- b. Amortization expenses amounted to \$ 367 and \$ 1,124 for the years ended December 31, 2004 and 2005, respectively.
- c. Technology acquired from VisionNex in 2004 is amortized over a period of 1.5 years. The technology is fully amortized as of December 31, 2005. Technology acquired from FVC in 2005 is amortized over a period of 4 years.
- d. Distribution networks are amortized over a period of 4 years.

Following is the estimated amortization expenses in respect of identifiable intangible assets for the years ended:

2006	\$ 1,090
2007	1,090
2008	1,090
2009	272
	<u>\$ 3,542</u>

**NOTE 7:- SHORT-TERM BANK CREDIT**

The Company has an authorized credit line from a bank in the amount of \$ 2,522. A total of \$ 2,047 was not utilized as of December 31, 2005. \$ 369 was utilized by the granting of bank guarantees (see Note 9c).

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 8:- ACCRUED EXPENSES AND OTHER ACCOUNTS PAYABLE**

	<u>December 31,</u>	
	<u>2004</u>	<u>2005</u>
Payroll and related accruals	\$ 2,408	\$ 3,133
Accrued expenses and other liabilities	9,541	8,989
	<u>\$ 11,949</u>	<u>\$ 12,122</u>

**NOTE 9:- COMMITMENTS AND CONTINGENCIES**

- a. In connection with its research and development, the Company received participation payments from the Israel U.S. Binational Industrial Research and Development Foundation ("BIRD-F"), in the total amount of approximately \$ 188. In return for the participation, the Company is committed to pay royalties at a rate of 2.5% of proceeds from the first year's sales and 5% of the proceeds from the succeeding years' sales, up to the amount of the grant. Once the amount of the grant has been repaid, royalties will be payable at the rate of 2.5% of proceeds, until additional royalties equal to one half of the grant amount have been repaid. The Company's total commitment for royalties payable with respect to future sales, based on BIRD-F participations received or accrued, net of royalties paid or accrued, totaled approximately \$ 276 as of December 31, 2004 and 2005. During 2005, the Company did not pay or accrue royalties to the BIRD-F.
- b. The Company and its subsidiaries operate from leased premises in Israel, the United States, China, Japan, the United Kingdom and Hong Kong. The leases expire through June 2010 (some with renewal options). The Company leases its motor vehicles under operating lease agreements that expire on various dates, the latest of which is in 2010.

Annual minimum future lease payments due under the above agreements, at the exchange rate in effect on December 31, 2005, are approximately as follows:

2006	\$ 2,710
2007	2,043
2008	1,445
2009	1,393
2010	633
	<u>\$ 8,224</u>

For the years ended December 31, 2003, 2004 and 2005, rent expenses and motor vehicle lease expenses were \$ 2,697, \$ 2,636 and \$ 3,025, respectively.

- c. The Company obtained bank guarantees in the amount of \$ 369 in connection with securing its rent agreement of the Company's office space in Israel and in connection with custom tax payments.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 9:- COMMITMENTS AND CONTINGENCIES (Cont.)**

- d. The Company is committed to pay royalties to several third parties for the integration of these third parties' technologies into the Company's products. Royalties are payable based on the sales volume of these products, as long as the Company uses these technologies.

The rates of royalties to the third parties are based on an amount per product sold by the Company ranging from \$ 1.00 to \$ 5.00 (in dollars) per unit sold.

The agreements pursuant to which the royalties are payable have no expiration date.

The Company expensed royalties in the amount of \$ 89, \$ 237 and \$ 334 in 2003, 2004 and 2005, respectively.

- e. In 1998, a third party sent correspondence to a related party of the Company alleging that some products manufactured by the Company infringe upon patents held by the third party and offered to license these patents to the Company. In subsequent correspondence, the Company's related party requested that the third party specifically substantiate each allegation of infringement before the Company's related party would be prepared to enter into any licensing arrangements. The Company does not believe that these allegations will have a material adverse effect upon its business, financial position, results of operations or liquidity. The Company's related party has received further correspondence from the third party, in which the third party has, among other things, reiterated its claims. The Company's related party does not believe the third party has substantiated its claims and has communicated this belief to the third party. The Company's related party has advised the Company that the alleged infringement claims are unresolved.

In 2003, another third party sent correspondence to the Company alleging that some products manufactured by the Company infringe upon patents held by this third party and offered to license these patents to the Company. Subsequent correspondence was held during 2004, in which additional requests were made by this third party.

The Company has recorded a provision, which it believes covers the potential loss from such allegations.

In late 2005, another third party sent correspondence to the Company alleging that some products manufactured by the Company infringe upon patents held by the third party and offered to license these patents to our company. We have been studying the material furnished and have hired outside expert counsel to help us analyze the nature and extent of the matter. The parties have exchanged correspondence but due to the preliminary stage of the discussions the Company and its external legal counsel are unable to assert whether there is a potential loss from this allegation at this time.

- f. In early 2005, the Company terminated an exclusive distributor agreement with a third party in China, due to their alleged material breach of contract. The third party prepared a law suit against the Company and its principal officers and sent copies of the law suit to each of our directors. To the best of the Company's knowledge, no such law suit has been filed. Should such a law suit be filed, the Company intends to vigorously defend it and raise substantial counterclaims against the third party.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 9:- COMMITMENTS AND CONTINGENCIES (Cont.)**

## g. Stamp tax duty:

Prior to January 1, 2006 under Israel's Stamp Tax on Documents Law, certain documents were subject to stamp tax. Recently promulgated regulations provide for a gradual phase-out of the stamp tax by 2008.

In 2004, however, the Tax Authorities began an enforcement campaign involving extensive audits of companies' compliance with the stamp tax obligation with respect to all agreements which had been signed since June 2003.

In December 2005, the Stamp Tax on Documents Law was cancelled effective January 1, 2006

The Company has received legal advice that there are a variety of defenses relating to its obligation to pay stamp tax or to the amount to be paid. The Company's management believes that the applicable provision in its financial statements as of December 31, 2005, is adequate to cover probable costs arising from this law.

**NOTE 10:- SHAREHOLDERS' EQUITY**

- a. The Ordinary shares of the Company are traded on the NASDAQ National Market and on the Tel Aviv Stock Exchange.

The Ordinary shares confer upon their holders the right to receive notice, to participate and vote in general meetings of the Company, and the right to receive dividends, if declared.

- b. In February 2001, the Company announced that its Board of Directors authorized the purchase of up to 10% of its outstanding Ordinary shares in the open market, from time to time, at prevailing market prices. No time limit was given with respect to the duration of the share purchase program.

As of December 31, 2004, the Company reissued all of its purchased Ordinary shares in consideration for the exercise of stock options by employees.

Such purchases of Ordinary shares are accounted for as treasury stock and result in a reduction of shareholders' equity. When treasury stock is reissued, the Company accounts for the re-issuance in accordance with Accounting Principles Board No. 6, "Status of Accounting Research Bulletins" ("APB No. 6") and charges the excess of the purchase cost over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the weighted average method. In case the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)**

- c. The Company adopted an employee share incentive plan which provides for the grant by the Company of option awards to purchase up to an aggregate of 9,129,899 Ordinary shares to officers, employees, directors and consultants of the Company and its subsidiaries. The options vest ratably over vesting periods of about 4 years. The options expire 5 to 10 years from the date of issuance. The incentive plan provides for the grant of options equal in the number of up to 4% of the Company's Ordinary shares on a diluted basis.

As of December 31, 2005, 374,435 shares are available for future grant. Options that are cancelled or forfeited before expiration become available for future grant.

Transactions related to the share incentive plan during the years ended December 31, 2003, 2004 and 2005, and the weighted average exercise prices per share at the date of grant, are summarized as follows:

	Year ended December 31,					
	2003		2004		2005	
	Amount	Weighted average exercise price	Amount	Weighted average exercise price	Amount	Weighted average exercise price
Options outstanding at the beginning of the year	4,410,936	\$ 6.99	4,754,856	\$ 7.98	4,295,742	\$ 9.41
Granted	1,749,700	\$ 8.19	1,521,750	\$ 11.61	1,557,100	\$ 13.01
Exercised	(1,072,919)	\$ 4.25	(1,224,169)	\$ 5.31	(1,234,979)	\$ 7.42
Forfeited	(332,861)	\$ 7.96	(756,695)	\$ 11.47	(1,095,040)	\$ 11.91
Options outstanding at the end of the year	<u>4,754,856</u>	<u>\$ 7.98</u>	<u>4,295,742</u>	<u>\$ 9.41</u>	<u>3,522,823</u>	<u>\$ 10.91</u>
Options exercisable at the end of the year	<u>1,610,343</u>	<u>\$ 8.99</u>	<u>1,456,032</u>	<u>\$ 9.92</u>	<u>959,532</u>	<u>\$ 9.11</u>

A summary of the options outstanding and exercisable at December 31, 2005, is as follows:

Range of exercise price	Options outstanding			Options exercisable	
	Outstanding as of December 31, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price	Outstanding as of December 31, 2005	Weighted average exercise price
\$ 4.57 - \$ 5.57	421,628	6.28	\$ 5.22	269,262	\$ 5.20
\$ 5.81 - \$ 6.70	323,728	6.43	\$ 5.80	198,663	\$ 6.28
\$ 7.62 - \$ 8.78	205,736	7.40	\$ 9.16	81,486	\$ 8.26
\$ 9.84 - \$ 10.58	203,881	8.72	\$ 9.92	27,055	\$ 9.95
\$ 10.80 - \$ 12.00	681,250	8.64	\$ 11.37	157,384	\$ 11.22
\$ 12.04 - \$ 14.00	1,457,600	8.78	\$ 12.55	192,182	\$ 12.72
\$ 17.73	195,500	9.93	\$ 17.73	-	\$ -
\$ 28.00	33,500	4.54	\$ 28.00	33,500	\$ 28.00
	<u>3,522,823</u>		<u>\$ 10.91</u>	<u>959,532</u>	<u>\$ 9.11</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)**

Under APB No. 25, the amortization of deferred compensation expense for the years ended December 31, 2003, 2004 and 2005 amounted to \$ 117, \$ 0 and \$ 0, respectively. Options granted during 2003, 2004 and 2005 were granted at exercise prices equal to their market price.

The weighted average fair values on the date grant of the options granted during 2003, 2004 and 2005 were as follows:

Year ended December 31,					
2003		2004		2005	
Options	Weighted average fair value	Options	Weighted average fair value	Options	Weighted average fair value
1,749,700	\$ 4.25	1,521,750	\$ 4.29	1,557,100	\$ 4.62

In the event that cash dividends are declared in the future, such dividends will be paid in NIS or in foreign currency subject to any statutory limitations. The Company does not intend to pay cash dividends in the foreseeable future. The Company has decided not to declare dividends out of tax exempt earnings (see Note 15).

**NOTE 11:- NET EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted net earnings per share:

	Year ended December 31,		
	2003	2004	2005
Numerator:			
Net income	\$ 4,562	\$ 5,984	\$ 14,690
Denominator:			
Weighted average number of Ordinary shares outstanding during the year used to compute basic net earnings per share	18,660,444	19,822,061	21,121,908
Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock)	1,302,816	1,577,263	1,093,041
Weighted average number of Ordinary shares used to compute diluted net earnings per share	19,963,260	21,399,324	22,214,949
Basic net earnings per Ordinary share	\$ 0.24	\$ 0.30	\$ 0.70
Diluted net earnings per Ordinary share	\$ 0.23	\$ 0.28	\$ 0.66

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 12:- SEGMENT REPORTING AND GEOGRAPHICAL INFORMATION**

- a. The Company operates under two reportable segments: the Technology Business Unit ("TBU") and the Networking Business Unit ("NBU").

The TBU is responsible for the development of enabling technologies for real-time voice and video over IP. The NBU is responsible for developing networking products for IP-centric voice, video and data conferencing services. There are no significant transactions between the two segments.

The Company evaluates segment performance based on revenues and operating income (loss) of each segment.

The Company's reportable operating segments have been determined in accordance with the Company's internal management structure, which is organized based on operating activities. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

- b. The following is information about reported segment gains and losses:

	<u>NBU</u>	<u>TBU</u>	<u>Total</u>
<b>2005</b>			
Total revenues	\$ 51,295	\$ 22,717	\$ 74,012
Expenses	<u>49,725</u>	<u>12,760</u>	<u>62,485</u>
Segment income	<u>\$ 1,570</u>	<u>\$ 9,957</u>	11,527
Financial income			<u>3,051</u>
Income before taxes on income			<u>\$ 14,578</u>
Taxes on income			<u>\$ 112</u>
Net income			<u>\$ 14,690</u>
Depreciation and amortization	<u>\$ 2,187</u>	<u>\$ 402</u>	<u>\$ 2,589</u>
<b>2004</b>			
Total revenues	\$ 44,812	\$ 19,424	\$ 64,236
Expenses	<u>46,245</u>	<u>13,867</u>	<u>60,112</u>
Segment income	<u>\$ (1,433)</u>	<u>\$ 5,557</u>	4,124
Financial income			<u>1,860</u>
Net income			<u>\$ 5,984</u>
Depreciation and amortization	<u>\$ 1,809</u>	<u>\$ 704</u>	<u>\$ 2,513</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 12:- SEGMENT REPORTING AND GEOGRAPHICAL INFORMATION (Cont.)**

	<u>NBU</u>	<u>TBU</u>	<u>Total</u>
<b>2003</b>			
Total revenues	\$ 38,059	\$ 13,245	\$ 51,304
Expenses	<u>38,454</u>	<u>11,479</u>	<u>49,933</u>
Segment income (loss)	<u>\$ (395)</u>	<u>\$ 1,766</u>	1,371
Restructuring income			1,061
Financial income			<u>2,130</u>
Net income			<u>\$ 4,562</u>
Depreciation and amortization	<u>\$ 1,386</u>	<u>\$ 540</u>	<u>\$ 1,926</u>

## c. Summary information about geographic areas:

The following represents total revenues according to the end customer's location for the years ended December 31, 2003, 2004 and 2005, and long-lived assets as of December 31, 2004 and 2005 according to their geographic location:

	<u>2003</u>	<u>2004</u>		<u>2005</u>	
	<u>Total revenues</u>	<u>Total revenues</u>	<u>Long-lived assets</u>	<u>Total Revenues</u>	<u>Long-lived assets</u>
North America (principally the United States)	\$ 24,407	\$ 33,660	\$ 481	\$ 40,075	\$ 485
Europe	11,191	15,616	9	16,030	80
Far East	12,672	11,688	262	13,064	532
Israel	3,034	<u>3,272</u>	<u>2,848</u>	<u>4,843</u>	<u>8,601</u>
	<u>\$ 51,304</u>	<u>\$ 64,236</u>	<u>\$ 3,600</u>	<u>\$ 74,012</u>	<u>\$ 9,698</u>

- d. The Company does not allocate its assets to its reportable segments accordingly; asset information by reportable segments is not presented.
- e. For the years ended December 31, 2003, 2004 and 2005, one customer accounted for approximately 21.3%, 27.2% and 26.5%, respectively, of sales for that period.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 13:- RESTRUCTURING INCOME**

In January 2001, the Company entered into an agreement with related parties, to lease approximately 24,000 square feet of office space in Paramus, New Jersey for a period of five years. Subsequently, as part of the restructuring that took place in 2001, the Company surrendered the property before the inception of the lease. The parties had a dispute with respect to the extent of damages caused by this action and agreed to a binding arbitration. The presiding arbitrator issued his final ruling on February 12, 2004, stating the amount owed by the Company was \$ 400. In conjunction with the aforementioned restructuring, the Company had accrued in respect of the above dispute \$ 1,461. As a result of the arbitrator's ruling, as of December 31, 2003, the Company revised the related accrual to \$ 400 and in 2003 recorded restructuring income of \$ 1,061. The amount of \$ 400 award was paid to the related party in 2004.

**NOTE 14:- RELATED PARTIES BALANCES AND TRANSACTIONS**

## a. Balances with related parties:

	December 31,	
	2004	2005
Trade receivables	\$ 17	\$ 66
Trade payables	\$ 158	\$ 171

## b. Transactions with related parties:

	Year ended December 31,		
	2003	2004	2005
Revenues (1)	\$ -	\$ 214	\$ 103
Cost of revenues (3)	\$ 66	\$ 39	\$ 16
Research and development expenses (2)	\$ 379	\$ 143	\$ 81
Marketing, selling, general and administrative expenses (2)	\$ 207	\$ 455	\$ 441
Purchase of property and equipment (4)	\$ 530	\$ 624	\$ 665

- (1) Includes revenues from the Company's products and maintenance sold to companies held by principal shareholders ("affiliated companies").
- (2) Includes administrative services provided to the Company by affiliated companies that the Company reimburses for the costs incurred in providing these services.
- (3) Includes the purchase of components from affiliated companies.
- (4) Includes property and equipment that were purchased from affiliated companies.

- c. During 2003, the Company recorded restructuring income of \$1,061 due to a reversal of an accrual relating to the dispute with a related party (see Note 13 above).

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 15:- TAXES ON INCOME**

## a. Reduction in Israeli tax rates:

Until December 31, 2003, the regular tax rate applicable to income of companies (which are not entitled to benefits due to "Approved Enterprise", as described above) was 36%. In June 2004 and in July 2005, the "Knesset" (Israeli parliament) passed amendments to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 and (No. 147), 2005 respectively, which determine, among other things, that the corporate tax rate is to be gradually reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

## b. Tax benefits under the Law for the Encouragement of Capital Investment, 1959 ("the Law"):

The Company has three capital investment programs that have been granted "Approved Enterprise" status under the Law for Encouragement of Capital Investments, 1959. Pursuant to the approved programs, the Company is entitled to a tax benefit period of seven to 10 years, on income derived from these programs, as follows: a full income tax exemption for the first two years and a reduced income tax rate of 10% -25% (instead of the regular rate of 34% in 2005) for the remaining five to eight years (depending on the level of non-Israeli investments in the Company).

The duration of tax benefits detailed above is subject to limits of 12 years from the year of commencement of production, or 14 years from the date of granting the approval, whichever is earlier. The Company's plans expire between the years 2009 and 2017.

The Company has not yet generated taxable income and, thus, the tax benefits have not yet been utilized.

The tax-exempt income attributable to the "Approved Enterprise" cannot be distributed to shareholders without subjecting the Company to taxes. If these retained tax-exempt profits are distributed, the Company would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits, currently between 10%-25% for an "Approved Enterprise". As of December 31, 2005, the retained earnings of the Company do not include tax-exempt profits earned by the Company's "Approved Enterprise".

The benefits from the Company's "Approved Enterprise" programs are dependent upon the Company fulfilling the conditions stipulated by the Law and the regulations published thereunder as well as the criteria in the approval for the specific investment in the Company's "Approved Enterprise" programs. 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's management believes that it has complied with these conditions.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 15:- TAXES ON INCOME (Cont.)**

By virtue of this Law, the Company is entitled to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular Israeli corporate tax rate.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a Privileged Enterprise, such as provisions generally requiring that at least 25% of the Privileged Enterprise's income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. However, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore the Company's existing Approved Enterprise will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the new law, will subject the Company to taxes upon distribution or liquidation and the Company may be required to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2005, the Company did not generate income under the provision of the new law.

- c. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured and reflected in real terms in accordance with the change in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the consolidated financial statements are presented in dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate causes a difference between taxable income or loss and the income or loss before taxes reflected in the consolidated financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the differences resulting from changes in exchange rates and indexing for tax purposes.

- d. Tax benefits under Israel's Law for the Encouragement of Industry (Taxation), 1969:

The Company is an "Industrial Company", as defined by the Law for the Encouragement of Industry (Taxation), 1969, and as such, is entitled to claim public issuance expenses over three tax years and accelerated depreciation on equipment.

- e. As of December 31, 2005, the Company's net operating loss carryforwards for tax purposes amounted to approximately \$4,800. These net operating losses may be carried forward indefinitely and may be offset against future taxable income. The Company expects that during the period in which these tax losses are utilized its income would be substantially tax-exempt.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 15:- TAXES ON INCOME (Cont.)**

- f. The U.S. subsidiary's carryforward tax losses through December 31, 2005, amounted to approximately \$ 15,300. These losses may be offset against any future U.S. taxable income of the U.S. subsidiary and will expire in the years 2011 through 2023. In light of the U.S. subsidiary's recent history of operating losses, the Company has recorded a valuation allowance for all its deferred tax assets.

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

- g. Deferred income taxes:

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

	December 31,	
	2004	2005
Net operating loss carryforwards	\$ 4,974	\$ 6,142
Reserves and allowances	1,191	1,093
Other temporary differences	16	118
	6,181	7,353
Net deferred tax asset before valuation allowance	(6,181)	(7,150)
Valuation allowance	-	203
	\$ -	\$ 203

The Company's U.S. subsidiary provided valuation allowances in respect of the aforementioned deferred tax assets since management currently believes that it is not more likely than not that the deferred tax regarding the loss carryforwards will be realized. The change in the valuation allowance as of December 31, 2005 was an addition of \$ 969.

- h. The Company's total income before provision for income taxes is as follows:

	Year ended December 31,		
	2003	2004	2005
Domestic (Israel)	\$ 3,948	\$ 2,433	\$ 12,932
Foreign	614	3,551	1,646
	\$ 4,562	\$ 5,984	\$ 14,578
	\$ 4,562	\$ 5,984	\$ 14,578

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 15:- TAXES ON INCOME (Cont.)**

i. The tax benefits is comprised as follows:

	Year ended December 31,		
	2003	2004	2005
Domestic (Israel):			
Deferred taxes	\$ -	\$ -	\$ 203
Foreign:			
Current taxes	-	-	(91)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 112</u>

j. A reconciliation between the theoretical tax income, assuming all income is taxed at the statutory tax rate applicable to the income of the Company and the actual tax income as reported in the statements of income is as follows:

	Year ended December 31,		
	2003	2004	2005
Income before taxes on income	<u>\$ 4,562</u>	<u>\$ 5,984</u>	<u>\$ 14,578</u>
Theoretical tax expense computed at the statutory rate *)	\$ 1,648	\$ 2,094	\$ 4,957
Valuation allowance for deferred tax assets in respect of loss carryforwards	215	-	-
Reversal of valuation allowance	-	(1,279)	(533)
Tax exempt income due to approved enterprise status	(2,034)	(1,118)	(4,990)
Non-deductible expenses and others	171	303	454
Actual tax benefit, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (112)</u>
Basic net earnings per Ordinary share	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 0.001</u>
Diluted net earnings per Ordinary share	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 0.001</u>

\*) The tax rates for domestic income are 36%, 35% and 34% for the years 2003, 2004 and 2005, respectively. The tax rate for foreign income is about 35%.

**Management**

Boaz Raviv  
Eli Doron  
Tsipi Kagan  
Killko Caballero  
Zeev Bikowsky  
Irit Machtey  
Arnie Taragin  
Robert Rickwood  
Eitan Levine  
Ron Bleakney  
Ilan Givon

Chief Executive Officer  
President and Chief Strategy Officer  
Chief Financial Officer  
Senior Vice President of Enterprise Strategy  
General Manager, Technology Business Unit  
Senior Vice President Organization & Human Resources  
Corporate Vice President and General Counsel  
General Manager, Europe, Middle East and Africa  
General Manager, Asia-Pacific  
General Manager, the Americas  
Vice President Operation

**Board of Directors**

Zohar Zisapel  
Joseph Atsmon  
Dan Barnea  
Liora Katzenstein  
Andreas Mattes  
Efraim Wachtel

Chairman of the Board of Directors  
Director, Chairman of the Company Audit Committee  
Director  
Director  
Director  
Director

**Stock Listing**

NASDAQ  
National Market Systems  
Symbol: RVSN  
Common Stock  
  
TASE  
Tel-Aviv Stock Exchange  
Symbol: תרנ  
Common Stock

**Independent Accountant**

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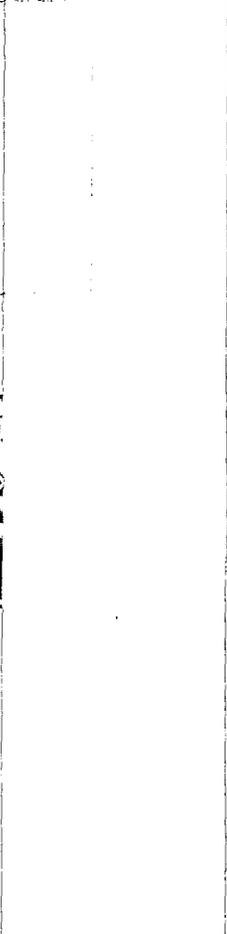
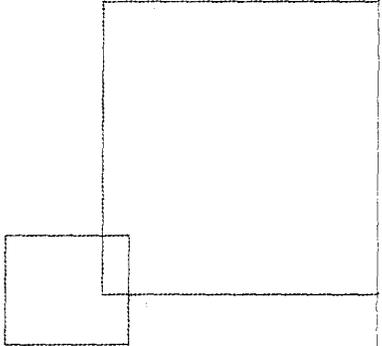








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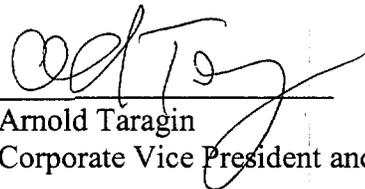
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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RADVISION LTD.  
(Registrant)

By   
Arnold Taragin  
Corporate Vice President and General Counsel

Date: May 18, 2006