

RADWARE LTD  
Form 20-F  
March 28, 2013

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended  
December 31, 2012

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report \_\_\_\_\_

Commission file number 0-30324

RADWARE LTD.  
(Exact name of registrant as specified in its charter)

Israel  
(Jurisdiction of incorporation or organization)

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

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

|                             |                          |
|-----------------------------|--------------------------|
| Title of each class         | Name of each exchange on |
| Ordinary Shares,            | which registered         |
| NIS 0.1 par value per share | The Nasdaq Stock Market  |
|                             | LLC                      |

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

None  
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report (December 31, 2012):

22,185,452 Ordinary Shares, NIS 0.1 par value per share

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

☐ Yes ☒ No

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

☐ Yes ☒ No

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

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☒ Yes ☐ No

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

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

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

☒ U.S. GAAP

☐ International Financial Reporting Standards as issued by the International Accounting Standards Board

☐ Other

If “Other” has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow:

☐ Item 17 ☐ Item 18

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

☐ Yes ☒ No



## INTRODUCTION

Unless the context otherwise requires, all references in this annual report to:

- “we,” “us,” “our,” the “Company,” and “Radware” are to Radware Ltd. and its subsidiaries;
- “ordinary shares” are to our Ordinary Shares, par value NIS 0.1 per share;
- “Companies Law” or the “Israeli Companies Law” are to the Israeli Companies Law, 5759-1999, as amended;
- the “SEC” are to the U.S. Securities and Exchange Commission;
- “U.S. GAAP” are to generally accepted accounting principles in the United States;
- “NASDAQ” are to the NASDAQ Global Market (formerly, the Nasdaq National Market);
- “dollars”, “\$” or “US \$” are to U.S. dollars; and
- “NIS” or “shekels” are to New Israeli Shekels.

We have registered trademarks for, among others, “Radware®”, “APSolute®”, “Web Server Director®”, “FireProof®”, “LinkProof®”, “Triangulation®”, “Smart Nat®”, “DefensePro®”, “StringMatch Engine®”, “CID®”, “CID – Content Ins Director®”, “SIPDirector®”, “AppDirector®”, “AppXcel®”, “AppXML®”, “SecureFlow®”, “OnDemand Switch®”, “App “Absolute Insite®”, “APSolute Vision®”, “vAdapter®”, VADI®, “Alteon®” and “ALTEON VA®”, and we have trademarks for applications pending for, among others, “Virtual Director™”, “vDirect™”, “ADC Fabric™”, “Radware ADC Fabric™”, “AppShape™”, “TeraVIP™”, “DefensePipe™” and “DefenseFlow™”. Unless the context otherwise indicates, all other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in dollars and in accordance with U.S. GAAP, and are audited in accordance with the standards of the Public Company Accounting Oversight Board in the United States.

On March 28, 2013, we announced that we will effect a two-for-one forward split of our ordinary shares, and accordingly the par value of our ordinary shares will be changed from NIS 0.1 to NIS 0.05 per share. The stock split is expected to become effective on April 12, 2013. All ordinary share, option and per share amounts as well as stock prices in this annual report are before the split and, consequently, do not take it into account.

On March 10, 2013, the exchange rate between the NIS and the dollar, as quoted by the Bank of Israel, was NIS 3.69 to \$1.00. Unless the context otherwise indicates, statements in this annual report that provide the dollar equivalent of NIS amounts or provide the NIS equivalent of dollar amounts are based on such exchange rate.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms, and the summary included herein is qualified by reference to the full text of the document which is incorporated by reference into this annual report.

## CAUTIONARY STATEMENT REGARDING

FORWARD-LOOKING STATEMENTS

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

We urge you to consider that statements which use the terms “believe,” “do not believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate,” and similar expressions are intended to identify forward-looking statements. Such forward-looking statements appear in Item 3.D “Risk Factors”, Item 4 “Information on the Company”, and Item 5 “Operating and Financial Review and Prospects” as well as elsewhere in this annual report. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties, including those discussed under Item 3.D “Risk Factors” and in our other filings with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

## ITEM 3.

## KEY INFORMATION

## A. Selected Financial Data

The following tables present selected information from our consolidated statement of operations and balance sheet data for the periods and as of the dates indicated. We derived the selected consolidated statement of operations for the years ended December 31, 2010, 2011 and 2012 and the selected balance sheet data as of December 31, 2011 and 2012 from our audited consolidated financial statements included elsewhere in this annual report, which have been prepared in accordance with U.S. GAAP. The selected consolidated statement of operations data for the years ended December 31, 2008 and 2009 and the selected balance sheet data as of December 31, 2008, 2009 and 2010 are derived from our audited consolidated financial statements not included in this annual report, which have been prepared in accordance with U.S. GAAP.

You should read the following selected financial data together with the section of this annual report entitled “Operating and Financial Review and Prospects” and our consolidated financial statements together with the notes thereto included elsewhere in this annual report.

|  | 2008        | Year ended December 31,                    |          |           |           |
|--|-------------|--|----------|-----------|-----------|
|  |             | 2009                                       | 2010     | 2011      | 2012      |
|  |             | (US \$ in thousands except per share data) |          |           |           |
| Statement of Operations Data:          |             |  |          |           |           |
| Revenues:                              | \$59,678    | \$65,021                                   | \$89,358 | \$103,285 | \$119,279 |
| Products                               | 34,903      | 43,883                                     | 54,761   | 63,735    | 69,892    |
| Services                               | 94,581      | 108,904                                    | 144,119  | 167,020   | 189,171   |
|  |             |  |          |           |           |
| Cost of revenues:                      | 15,143      | 16,609                                     | 21,306   | 24,231    | 26,386    |
| Products                               | 6,431       | 6,666                                      | 7,898    | 9,126     | 9,333     |
| Services                               | 21,574      | 23,275                                     | 29,204   | 33,357    | 35,719    |
| Gross profit                           | 73,007      | 85,629                                     | 114,915  | 133,663   | 153,452   |
| Operating expenses:                    |             |  |          |           |           |
| Research and development, net          | 28,357      | 25,674                                     | 31,660   | 36,064    | 36,187    |
| Sales and marketing                    | 63,591      | 55,130                                     | 64,609   | 69,543    | 76,646    |
| General and administrative             | 12,066      | 11,930                                     | 10,190   | 9,629     | 9,696     |
| Total operating expenses               | 104,014     | 92,734                                     | 106,459  | 115,236   | 122,529   |
| Operating income (loss)                | (31,077 )   | (7,105 )                                   | 8,456    | 18,427    | 30,923    |
| Financial income, net                  | 3,612       | 1,987                                      | 2,057    | 4,200     | 4,792     |
| Income (loss) before income taxes      | (27,395 )   | (5,118 )                                   | 10,513   | 22,627    | 35,715    |
| Income taxes                           | (3,627 )    | (818 )                                     | (879 )   | (1,290 )  | (3,958 )  |
| Net income (loss)                      | \$(31,022 ) | \$(5,936 )                                 | \$9,634  | \$21,337  | \$31,757  |
|  |             |  |          |           |           |
| Basic net earnings (loss) per share*   | \$(1.60 )   | \$(0.31 )                                  | \$0.49   | \$1.02    | \$1.45    |
| Diluted net earnings (loss) per share* | \$(1.60 )   | \$(0.31 )                                  | \$0.44   | \$0.93    | \$1.36    |

\* Please see notes 2(x) and 11 to our consolidated financial statements for an explanation regarding the computation of basic and diluted net earnings (loss) per ordinary share.

|  | Year ended December 31, |        |        |        |        |
|--|-------------------------|--------|--------|--------|--------|
|  | 2008                    | 2009   | 2010   | 2011   | 2012   |
|  | (in thousands)          |        |        |        |        |
| Weighted average number of ordinary shares used in computing basic net earnings (loss) per share   | 19,440                  | 18,879 | 19,558 | 20,953 | 21,855 |
| Weighted average number of ordinary shares used in computing diluted net earnings (loss) per share | 19,440                  | 18,879 | 21,734 | 22,888 | 23,294 |

|   | As of December 31,   |           |           |            |           |
|---|----------------------|-----------|-----------|------------|-----------|
|   | 2008                 | 2009      | 2010      | 2011       | 2012      |
|   | (US \$ in thousands) |           |           |            |           |
| Balance Sheet Data:   |                      |           |           |            |           |
| Cash and cash equivalents, short-term bank deposits and marketable securities | \$ 88,796            | \$ 59,090 | \$ 90,925 | \$ 116,493 | \$ 88,207 |
| Long-term bank deposits, structured deposit and marketable securities         | 45,112               | 67,021    | 87,864    | 102,644    | 186,739   |
| Working capital   | 82,292               | 49,573    | 67,456    | 89,076     | 56,615    |
| Total assets  | 185,464              | 208,900   | 260,635   | 295,191    | 357,650   |
| Shareholders' equity  | 148,062              | 149,473   | 184,990   | 219,321    | 271,230   |
| Capital Stock   | 186,450              | 192,406   | 219,099   | 233,927    | 250,338   |

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors**

You should carefully consider the following risks before deciding to purchase, hold or sell our ordinary shares. Our business, operating results and financial condition could be seriously harmed due to any of the following risks. The following risks are not the only risk factors facing our Company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. The trading price of our ordinary shares could decline due to any of these risks. You should also refer to the other information contained or incorporated by reference in this annual report, before making any investment decision regarding our Company.

## Risks Related to Our Business and Our Industry

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

Although we were profitable in the past three years, we incurred losses from 2006 through 2009.

Our results for 2012 reflect our continued growth, combined with the growth in the information technology, or IT, market in which we operate. In 2012, we increased our profitability as a result of a combination of several factors, including increased revenues and continued expense controls, which enabled us to increase our operating expenses at a slower pace as compared to the increase in our revenues. Our ability to sustain profitability in the future depends in part on the global economy; the rate of growth of, and changes in technology trends in, our market and other industries in which we currently or may in the future operate; our ability to develop and manufacture new products and technologies in a timely manner; the competitive position of our products; the continued acceptance of our products by our customers and in the industries that we serve; and our ability to manage expenses. In the future, we may have to undertake cost reduction initiatives to remain profitable, which could lead to a deterioration of our competitive position, and any difficulty in reducing our cost structure could negatively impact our results of operations and cash flows. We cannot assure you that we will continue to remain profitable.

Our revenues also may not grow or continue at their current level, which could negatively impact our results of operations and cash flows. For example, the growth rate in 2011 compared to 2010 was approximately 16% and the growth rate in 2012 compared to 2011 was approximately 13%.

We may also seek to increase our operating expenses during future periods. Our decision to increase operating expenses and the scope of such increase will depend upon several factors, including the market situation and the results that our past expenditures produce. We may continue to make additional expenditures in anticipation of generating higher revenues, which we may not realize, if at all, until sometime in the future. For example, in February 2013, we completed the acquisition of Strangeloop Networks Inc., or Strangeloop, a Canadian-based provider of Web performance acceleration solutions. This acquisition will result, among others, in additional research and development costs. In addition, during 2012, we continued our investment in developing and enhancing our products, and we may not recognize increased revenues from these products. A failure of any acquisitions or product developments to produce increased revenues could have a material adverse effect on our operations and profitability. In parallel to our investments in our products portfolio, we have invested in marketing plans and product promotion efforts. Our marketing efforts and any related go-to-market strategies may not result in increased revenues.

If our revenues do not increase as anticipated, or if our expenses increase, we may incur losses.

Severe global economic conditions and volatility of the market for our products, including slow-down in expenditures and other trends in our industry, could have a material adverse effect on our results of operations.

Our business is dependent on current and anticipated market demand for our products. For example, starting in late 2008 and lasting through much of 2009, the overall market's IT spending decreased due to the global real estate and financial slowdown which led to a recessionary period. More recently, credit and sovereign debt issues have destabilized certain European economies, thereby increasing global macroeconomic uncertainties. Uncertainty about current global economic conditions continues to pose a risk as customers may postpone or reduce spending in response to restraints on credit. Should the economic slowdown resume, and/or companies in our target markets reduce capital expenditures, we may experience a reduction in sales, as well as downward pressure on the price of our products. In addition, if the market is flat and customers experience low visibility we may not be able to increase our sales (whether direct sales or indirect sales through our distributors). Each of the above scenarios would have a material adverse effect on our business, operating results and financial condition.

If we are unable to realize our investment objectives, our financial condition and results of operations may be adversely affected.

Financial income is an important component of our net income. As of December 31, 2012, our investment portfolio, including cash and cash equivalents, had a carrying value of \$274.9 million, compared with \$219.1 million as of December 31, 2011. For the years ended December 31, 2012, 2011 and 2010, we had \$4.8 million, \$4.2 million and \$2.1 million, respectively, of financial income.

The outlook for our financial income is dependent, in part, on the future direction of interest rates, exchange rates, the amount of any share repurchases or acquisitions that we make and the amount of cash flows from operations that are available for investment. The performance of the capital markets, affects the values of our funds that are held in marketable securities. These assets are subject to market fluctuations and will yield uncertain returns. Due to certain market developments, including investments' rating downgrades, the fair value of these investments may decline. If market conditions continue to fluctuate, the fair value of our investments may be impacted accordingly. Although our investment guidelines stress diversification and capital preservation, our investments are subject to a variety of risks, including risks related to general economic conditions, interest rate fluctuations and market volatility.



In particular, our investment portfolios include a significant amount of interest rate-sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. Changes in interest rates and credit quality may also result in fluctuations in the income derived from, or the valuation of, our fixed income securities. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. For example, benchmark interest rates, such as the U.S. Federal Funds Rate, are currently at historic lows, which is likely to significantly impact our investment income. Increases in interest rates will decrease the value of our investments in fixed-income securities. If increases in interest rates occur during periods when we sell investments to satisfy liquidity needs, we may experience investment losses. Conversely, if interest rates decline, reinvested funds will earn less than expected.

In terms of credit risk, our investment portfolio policy is buy and hold, while minimizing credit risk by setting maximum concentration limit per issuer and credit rating. Our investments consist primarily of government and corporate debentures and bank deposits. Although we believe that we generally adhere to conservative investment guidelines, if the turmoil in the financial markets experienced during 2011 and 2012 reoccurs in the future, it may result in impairments of the carrying value of our investment assets since we classify our investments in marketable securities as available-for-sale. Changes in the fair value of investments classified as available-for-sale are not recognized as income during the period, but rather are recognized as a separate component of equity until realized. Realized losses in our investments portfolio may adversely affect our financial position and results. For example, if we had reported all the changes in the fair values of our investments into income, our reported net income would have increased by \$3.7 million during the year ended December 31, 2012 and decreased by \$1.8 during the year ended December 31, 2011.

Any significant decline in our financial income or the value of our investments as a result of continued low interest rates, deterioration in the credit worthiness of the securities in which we have invested, general market conditions or other factors, could have an adverse effect on our results of operations and financial condition.

We may experience significant fluctuations in our quarterly financial performance because of our limited order backlog, our need to develop new products, the long sales cycles of our products, and the seasonal fluctuations in our sales.

Our quarterly operating results have varied significantly in the past and may vary significantly in the future as a result of various factors, many of which are outside of our control, including our limited order backlog, our need to develop and introduce new and enhanced products and features, and the long sales cycles of our products.

In addition, our quarterly operating results have been, and are likely to continue to be, influenced by seasonal fluctuations in the sales of our products and services. Because our sales have grown year-over-year since our inception, these fluctuations may not be apparent from our historical financial statements. However, we believe that our sales and sales growth have been, and will continue to be, affected by the seasonal purchasing patterns of some of our customers. For example, we believe that our sales may be reduced during the first quarter of 2013 due to our customers' annual purchasing budget planning process and the third quarter of 2013 due to a slowdown in business activities during the summer months in Europe. Conversely, our sales during the fourth quarter of 2013 may be increased because some of our customers tend to make greater capital expenditures towards the end of their fiscal years. Based on these anticipated fluctuations in our markets, our sales and operating results in any quarter may not be indicative of future performance and it may be difficult for investors to properly evaluate our prospects.

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

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

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

The IT marketplace is competitive and has very few barriers to entry. In particular, the Application Delivery and Network Security markets in which we focus are highly competitive. We expect competition to intensify in the future, and we may lose market share if we are unable to compete effectively with our competitors.

Most of our competitors have greater financial, personnel and other resources than us, which may limit our ability to effectively compete with them. Our principal competitors in the Application Delivery solutions market include: F5 Networks, Inc., Cisco Systems, Inc., Citrix Systems, Inc., A10 Networks and Brocade Communications Systems, Inc. (Foundry Networks, Inc). In addition, we face competitors in the Network Security space, with respect to our Attack Mitigation Systems from Arbor Networks, Inc., Hewlett Packard, TippingPoint Technologies, Inc., Intel Corporation (McAfee, Inc.) and Sourcefire, Inc. We expect to continue to face additional competition as new participants enter the market or extend their portfolios into related technologies. Larger companies with substantial resources, brand recognition and sales channels may form alliances with or acquire competing Application Delivery or Network Security solutions and emerge as significant competitors.

Competition may result in lower prices or reduced demand for our products and a corresponding reduction in our ability to recover our costs, which may impair our ability to achieve, maintain and increase profitability. Furthermore, the dynamic market environment poses a challenge in predicting market trends and expected growth. We cannot assure you that we will be able to implement our business strategy in a manner that will allow us to be competitive. If any of our competitors offer products or services that are more competitive than ours, we could lose market share and our business, financial condition and results of operations could be materially and adversely affected as a result.

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

The markets for Application Delivery and Network Security solutions are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Our products typically constitute a critical portion of our customers' data centers. In recent years, the capacity of transactions in such data centers has been steadily increasing. Due to such increases in capacity and in order to remain competitive in our industry, we must address the increased needs of our customers by developing more powerful platforms for our products. Additionally, we must address increased demands by our customers for advancements in our applications in order to support our customers' growing needs and evolutions in their data centers. In order to meet this challenge and remain competitive in the market, we must introduce new enhancements to our existing product lines.

Accordingly, our future success will generally depend to a substantial extent on our ability to:

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

We are currently developing new products and enhancements to our existing products and services offerings. For example, DefensePipe™, launched in early 2013, is a comprehensive solution to help mitigate volumetric distributed denial-of-service (DDoS) attacks which threaten to saturate a customer's Internet pipe, or the 'outside line' that

connects enterprises to the web. Our development of new products and enhancement of our offerings is undertaken in an effort to remain competitive in our market, and our failure to do so could result in a decrease in our revenues. In addition, we must invest in research and development in order to remain competitive in our industry. However, there can be no assurances that continued investment and higher costs of research and development will ultimately result in us maintaining or increasing our market share, which would result in a decline to our operating results. If our research and development expenses increase without a corresponding increase in our revenues, it could have a material adverse effect on our operating results. We may not be able to successfully complete the development and market introduction of new products or product enhancements. If we fail to develop and deploy new products and product enhancements on a timely basis, or if we fail to gain market acceptance of our new products, our revenues will decline and we may lose market share to our competitors.

During 2011 and 2012, we invested in, and plan to continue to invest in 2013 in developing or when appropriate, acquiring, capabilities to advance our product offering and market vision. For example, our acquisition of Strangeloop in February 2013 was designed to enhance our web acceleration offerings to our customers. There is no assurance that we will be successful in marketing and selling our next generation Application Delivery and Network Security solutions, or that we will be able to grow revenues to justify our investments.

Our failure to develop and market new products or product enhancements on a timely basis or our failure to gain market acceptance of our new products could result in our loss of market share and our business and could materially and adversely affect our financial condition and results of operations.

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

In March 2009, we completed the purchase of certain assets from Nortel Networks Ltd., Nortel Networks Inc. and other Nortel entities (“Nortel”) in relation to the “Alteon®” product line (the “Alteon Acquisition”). Most recently, in February 2013, we acquired Strangeloop. As part of our business strategy, we may invest in or acquire other complimentary businesses, technologies or assets or enter into joint ventures or other strategic relationships with third parties. In connection with future acquisitions, we may assume liabilities, incur acquisition related costs, incur amortization expenses or realize write-offs on assets no longer being used or phased out. In addition, the future valuation of these acquisitions may decrease from the market price paid by us which could result in the impairment of our goodwill associated with the relevant assets. Moreover, our operation of any acquired or merged businesses, technologies or assets could involve numerous risks, including:

- post-merger integration problems resulting from the combination of any acquired operations with our own operations or from the combination of two or more operations into a new merged entity;
- diversion of management’s attention from our core business;
- substantial expenditures, which could divert funds from other corporate uses;
- entering markets in which we have little or no experience;
- loss of key employees of the acquired operations; and
- known or unknown contingent liabilities, including, but not limited to, tax and litigation costs.

We cannot be certain that any future acquisitions or mergers will be successful. If the operation of the business of any future acquisitions or mergers disrupts our operations, our results of operations may be adversely affected, and even if we successfully integrate the acquired business with our own, we may not receive the intended benefits of the acquisition. In addition, our pursuit of potential acquisitions may divert our management’s attention from our core business and require considerable cash outlays at the expense of our existing operations, whether or not such transactions are consummated.

In addition, from time to time we look beyond our core business to help secure our long-term future. To that end, we may, from time to time, make investments in technologies that may not be complimentary to our core business of Application Delivery and Network Security solutions. For example, during 2011 and 2012, we invested a total of approximately \$1.2 million in Radyoos Media Ltd. or Radyoos, our Israeli-based subsidiary, which primarily engages in developing a web based e-commerce platform. We cannot be certain that this or other investments will be successful or will contribute towards the achievement of our long-term objectives. Investments outside of our core

business could also expose us to new risks related to technologies with which we may have limited experience, if any.

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

We have a limited order backlog which makes revenues in any quarter highly dependent on orders received and delivered in that quarter. Consequently, a delay in our recognition of revenue may have a negative impact on our results of operations for a given quarter. We base our decisions regarding our operating expenses on anticipated revenue trends and our expense levels are relatively fixed. As such, because only a small portion of our expenses are dependent on our revenues, if our revenues fall below our expectations, our earnings and profitability for that period will be materially and adversely affected.

We depend upon independent distributors to sell our products to customers. If our distributors do not succeed in selling our products, we may not be able to operate profitably.

We sell our products primarily to independent distributors, including value added resellers (VARs), original equipment manufacturers (OEMs) and system integrators, and are highly dependent upon these distributors' active marketing and sales efforts. We currently have several dozen active independent distributors and resellers that sell our products to the end-user customer. Our distribution agreements with our distributors generally are non-exclusive, one-year agreements with no obligation on the part of our distributors to renew the agreements. Our distribution agreements also typically do not prevent our distributors from selling products of our competitors and do not contain minimum sales or marketing performance requirements. As a result, our distributors may give higher priority to products of our competitors or their own products, thereby reducing their efforts to sell our products. In addition, we may not be able to maintain our existing distribution relationships, and we may not be successful in replacing them on a timely basis or at all. We may also need to develop new distribution channels for new products, and we may not succeed in doing so. Any changes in our distribution channels, including a termination or other disruption of our commercial relationship with our distributors, or our inability to establish distribution channels for new products could impair our ability to sell our products and result in a material adverse effect on our business, financial condition and results of operations.

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

Our products are technologically complex and are typically intended for use in applications that may be critical to the business of our customers. As a result, our pre-sales process is often subject to delays associated with budgetary constraints, lengthy approval processes and procurement processes that typically accompany the design and testing of new equipment. The sales cycles of our products to new customers can last as long as twelve months (and in some cases, for example with carrier customers, even longer) from initial presentation to sale. This long sales cycle results in a delay to our recognition of revenue and results in our need to make significant investments in marketing and sales. Long sales cycles also subject us to risks not usually encountered in a short sales cycle, including our customers' budgetary constraints and internal acceptance reviews and processes prior to purchase. In addition, orders expected in one quarter could shift to another because of the timing of our customers' procurement decisions. Furthermore, customers may defer orders in anticipation of new products or product enhancements introduced by us or by our competitors. These factors complicate our planning processes and reduce the predictability of our earnings.

We must manage our anticipated growth effectively in order to maintain and increase our profitability.

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

In some cases, we may choose to increase our cost of operations on account of our short term profitability in order to support future expansion and growth. We cannot assure that we will continue to expand our operations successfully. If we are unable to manage our expanding operations effectively, our revenues may not increase, our cost of operations may rise and we may not be profitable.

In addition, as we continue our growth efforts, we may need new or enhanced systems, procedures or controls. The transition to new systems, procedures or controls, as well as any delay in transitioning to new or enhanced systems, procedures or controls, may result in increased costs and harm our ability to accurately forecast sales demand and manage our customer relationships.



Our international sales may expose us to additional risks

We currently offer our products in over 40 countries, including the U.S. For the years ended December 31, 2012 and 2011, our sales outside the Americas represented approximately 69% and 74%, respectively, of our total sales. Our international business activity involves varying degrees of risk and uncertainty inherent in doing business in so many different jurisdictions. Such risks include, among others, the possibility of unfavorable circumstances and additional compliance costs arising from host country laws or regulations, including unexpected changes of interpretations thereof; partial or total expropriation, export duties and quotas; local tax exposure; political instability, insurrection or war; differences in business practices; and recessionary environments in multiple foreign markets, such as those that occurred in some European countries during 2011 and 2012.

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

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

- A large portion of our expenses in Israel, principally salaries and related personnel expenses, are paid in shekels, whereas most of our revenues are generated in U.S. dollars. During 2012, we witnessed a weakening of the average exchange rate of the shekel against the U.S. dollar, which decreased the U.S. dollar value of Israeli expenses. If the shekel strengthens against the U.S. dollar, as happened in 2011, the value of our Israeli expenses will increase.
- A portion of our international sales are denominated in currencies other than U.S. dollars, such as the Euro, thereby exposing us to gains and losses on non-U.S. currency transactions.
- We incur expenses in several other currencies in connection with our operations in Europe and Asia.
- The devaluation of the U.S. dollar relative to such local currencies causes our operational expenses to increase.
- The majority of our international sales are denominated in U.S. dollars. Accordingly, devaluation in the local currencies of our customers relative to the U.S. dollar could cause our customers to decrease orders or default on payment.

We do not presently engage in or plan to engage in any hedging or other transactions intended to manage risks relating to foreign currency exchange rate fluctuations. Consequently, we are exposed to risks related to changes in currency exchange rates and fluctuations of exchange rates, any of which could result in a material adverse effect on our business, financial condition and results of operations. Even if we enter into hedging transactions in the future, they may not effectively protect us from currency exchange rate risks. For a further discussion of the impact on currency exchange rates on our business, see “Item 11. Quantitative and Qualitative Disclosures About Market Risk.”

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

As we grow, we may need to increase our research and development, sales and marketing, and support staff. Our products require a sophisticated marketing and sales effort targeted at several levels within a prospective customer’s organization. Accordingly, we need highly-trained sales, marketing and customer support personnel. Competition for such qualified personnel is intense. Consequently, we may not be able to hire sufficient personnel to support our business operations, which could result in a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

We rely on four third-party assembly and manufacturing vendors to provide our finished products. If such vendors are not able to provide us with adequate supplies of the products, we may be delayed in fulfilling orders or we may not be able to deliver sufficient quantities of our products to satisfy demand.

We rely on Nexcom International Co. Ltd. ("Nexcom"), USR Electronic Systems (1987) Ltd. ("USR"), Broadcom Corporation ("Broadcom") and Emerson Electric Co. ("Emerson") for the production of our products. For the year ended December 31, 2012, we purchased approximately 77%, 9%, 9% and 5% of our products from Nexcom, USR, Broadcom and Emerson, respectively. If we are unable to continue to acquire products from these manufacturers on acceptable terms, or should any of these manufacturers cease to supply us with such products for any reason, we may not be able to identify and integrate an alternative source of supply in a timely fashion or at the same costs. Any transition to one or more alternate manufacturers would likely result in delays, operational problems and increased costs, and may limit our ability to deliver our products to our customers on time for such transition period, any of which could result in a material adverse effect on our business, financial condition and results of operations.

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

Our growth and ability to meet customer demands depend in part on our ability to obtain timely deliveries of parts from our suppliers and contract manufacturers. We cannot assure you that we will not encounter supply and fulfillment issues in the future. Although in many cases we use standard parts and components for our products, certain components are presently available only from a single source or limited sources. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

We may experience a shortage of certain component parts as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers, or strong demand in the industry for those parts, especially if there is growth in the overall economy. If there is growth in the economy, such growth is likely to create greater pressures on us and our suppliers to accurately project overall component demand and component demands within specific product categories and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all.

We may also encounter shortages if we do not accurately anticipate our needs. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner in the quantities or configurations needed. Accordingly, our revenues and gross margins could be materially and adversely affected until other sources can be developed.

In addition, our operating results could be materially and adversely affected if we anticipate greater demand than actually develops and we commit to the purchase more components than we actually require.

Any disruption in our supply chain could result in a material adverse effect on our business, financial condition and results of operations.

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

Our success depends, in part, upon the protection of our proprietary software installed in our products, our trade secrets and our trademarks. We seek to protect our intellectual property rights through a combination of trademark and patent law, trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, distributors and others. In the United States and several other countries, we have registered or acquired trademarks. In addition, we have registered patents in the U.S. and have pending patent applications and provisional patents in connection with several of our products' features.

The protective steps we have taken may be inadequate to deter infringement upon our intellectual property rights or misappropriation of our proprietary information. We may be unable to detect the unauthorized use of our proprietary technology or take appropriate steps to enforce our intellectual property rights. Effective trademark, patent and trade secret protection may not be available in every country in which we offer, or intend to offer, our products. Failure to adequately protect our intellectual property rights could devalue our proprietary content, impair our ability to compete effectively and eventually harm our operating results. Furthermore, defending our intellectual property rights, either by way of initiating intellectual property litigation or defending such, could result in the expenditure of significant financial and managerial resources. Moreover, the outcome of such proceedings, if such outcome is negative, could result in devaluation of our proprietary technology and cause an additional significant financial impact which may harm our operating results.

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

Third parties may assert claims that we have violated a patent, trademark, copyright or other proprietary intellectual property right belonging to them. As is characteristic of our industry, there can be no assurance that our products do not or will not infringe the proprietary rights of third parties, that third parties will not claim infringement by us with respect to patents or other proprietary rights or that we would prevail in any such proceedings. We have received in the past, and may receive in the future, communications asserting that the technology used in some of our products requires third-party licenses. For example, see "Item 8. Financial Information – Legal Proceedings – SNMP Intellectual Property Claim." Any infringement claims, whether or not meritorious, could result in costly litigation or arbitration and divert the attention of technical and management personnel. Any adverse outcome in litigation alleging infringement could require us to develop non-infringing technology or enter into royalty or licensing agreements. If, in such situations, we are unable to obtain licenses on acceptable terms, we may be prevented from manufacturing or selling products that infringe such intellectual property of a third party. An unfavorable outcome or settlement regarding one or more of these matters could have a material adverse effect on our business and operating results.

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

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

Our bank deposits and investments in Israel are not insured, and our bank deposits in the United States are in excess of insured limits.

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

We are subject to certain tax audits, which could adversely affect our financial condition.

We operate our business in various countries, and we attempt to utilize an efficient operating model to optimize our tax payments based on the laws in the countries in which we operate. This can cause disputes between us and various tax authorities in the countries in which we operate whether due to tax positions that we have taken in various tax returns we have filed or due to determinations we have made not to file tax returns in certain jurisdictions. In particular, not all of our tax returns are final and may be subject to further audit and assessment by applicable tax authorities. There can be no assurance that the applicable tax authorities will accept our tax positions, and if they do not, we may be required to pay additional taxes, as a result of which, our future results may be adversely affected.

For example, in December 2010, following an audit of our Israeli tax returns for the 2004 and 2005 fiscal years, the Israeli Tax Authority (“ITA”) issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 16.1 million (approximately \$4.3 million) for 2004 and NIS 15.5 million (approximately \$4.2 million) for 2005, including interest as of the assessment date. In addition, in January 2012, following an audit of our Israeli tax returns for the 2006 and 2008 fiscal years, the ITA issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 25.2 million (approximately \$6.8 million) for 2006 and NIS 8.1 million (approximately \$2.2 million) for 2008, including interest as of the assessment date. We have appealed the orders relating to the four years mentioned above with the Tel Aviv District court, and these appeals are currently pending. There can be no assurance that the court will accept our positions on matters raised, and in such an event, we may be required to pay all or a portion of the amounts of these orders. Such a payment could result in a material adverse effect on our business, financial condition and results of operations.

#### Risks Related to the Market for Our Ordinary Shares

Yehuda Zisapel, our chairman of the board, his wife, Nava Zisapel, and Roy Zisapel, our chief executive officer, may exert significant influence in the election of our directors and over the outcome of other matters requiring shareholder approval.

As of March 10, 2013, Yehuda Zisapel, the Chairman of our Board of Directors, beneficially owned approximately 6.5% of our ordinary shares outstanding, his wife, Nava Zisapel beneficially owned approximately 7.0% of our ordinary shares outstanding and their son, Roy Zisapel, our Chief Executive Officer, President and director, beneficially owned approximately 5.7% of our ordinary shares outstanding (see “Item 6E – Directors, Senior Management and Employees - Share Ownership”). As a result, if these shareholders acted together, they could exert significant influence on the election of our directors and on decisions by our shareholders on matters submitted to shareholder vote, including mergers, consolidations and the sale of all or substantially all of our assets. This concentration of ownership of our ordinary shares could delay or prevent proxy contests, mergers, tender offers, or other purchases of our ordinary shares that might otherwise give our shareholders the opportunity to realize a premium over the then-prevailing market price for our ordinary shares. This concentration of ownership may also adversely affect our share price.

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

Generally, if for any taxable year (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the fair market value of our assets, averaged quarterly over our taxable year, are held for the production of, or produce, passive income, we would be characterized as a passive foreign investment company (“PFIC”) for U.S. federal income tax purposes. If we are classified as a PFIC, our U.S. shareholders could suffer adverse U.S. tax consequences, including having gain realized on the sale of our ordinary shares treated as ordinary income, as opposed to capital gain

income, and having potentially punitive interest charges apply to such sales proceeds. Similar rules apply to certain “excess distributions” made with respect to our ordinary shares.

For our 2012 taxable year, we do not believe that we should be classified as a PFIC. There can be no assurance, however, that the U.S. Internal Revenue Service (“IRS”) will not challenge this treatment, and it is possible that the IRS could attempt to treat us as a PFIC for 2012 and prior taxable years. The tests for determining PFIC status are applied annually, and it is difficult to make accurate predictions of our future income and assets and the future price of our ordinary shares, all of which are relevant to the PFIC determination. There can also be no assurance that we will not become a PFIC in future taxable years. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares. For a more detailed discussion of the rules relating to PFICs and related tax consequences, please see the section of this annual report entitled “Item 10 – Additional Information – Taxation — United States Federal Income Tax Considerations.”



We do not intend to pay cash dividends.

While we may engage from time to time in "buy-back" programs of our shares, our policy is to retain earnings for use in our business operations. For this reason, we do not intend to pay cash dividends on our ordinary shares in the foreseeable future.

Our share price has decreased significantly in the past and could continue to fluctuate and further decrease in the future.

The market price for our ordinary shares, as well as the prices of shares of other technology companies, has been volatile. Our share price decreased significantly during 2008, but has since recovered. The highest closing price of our shares during the first quarter of 2013 (through March 10, 2013) was \$38.55, compared to the lowest closing price of \$4.99 during 2008. Numerous factors, many of which are beyond our control, may cause the market price of our ordinary shares to fluctuate significantly and further decrease, including:

- fluctuations in our quarterly revenues and earnings and those of our publicly-traded competitors;
- shortfalls in our operating results from levels forecast by securities analysts;
- announcements concerning us or our competitors;
- the introduction of new products and new industry standards;
- changes in pricing policies by us or our competitors;
- general market conditions and changes in market conditions in our industry;
- the general state of the securities market (particularly the technology sector); and
- political, economic and other developments in the State of Israel, the U.S. and worldwide.

Provisions of our Articles of Association and Israeli law as well as the terms of our equity incentive plan could delay, prevent or make a change of control of us more difficult or costly, which could depress the price of our ordinary shares.

The provisions in our Articles of Association that provide that our directors, other than our external directors, are elected in three staggered classes by a majority vote of our shareholders may have the effect of delaying or making an unsolicited acquisition of our Company more difficult. Israeli corporate and tax law may also have the effect of delaying, preventing or making an acquisition of us more difficult. For example, under the Companies Law, upon the request of a creditor of either party to a proposed merger, an Israeli court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, our Key Employee Share Incentive Plan (1997), as amended, or the Share Incentive Plan, provides that, unless otherwise determined otherwise by our Board of Directors (or a committee thereof), in the event of a "Hostile Takeover", which is defined to include, among others, an unsolicited acquisition of more than 20% of our outstanding shares, the vesting of all or a portion of our outstanding equity awards, including stock options, will accelerate. As a result, an acquisition of our Company that triggers the said acceleration will be more costly to a potential acquirer. These provisions could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control over us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unwilling to do so

because of these provisions. For additional information on this topic, see “Item 6C – Board Practices – Staggered Board,” “Item 6E – Directors Senior Management and Employees – Share Ownership - Key Employee Share Incentive Plan” and “Item 10B – Additional Information – Memorandum and Articles of Association – Mergers and Acquisitions under Israeli Law.”

### Risks Related to Operations in Israel

Security and political and economic instability in the Middle East may harm our business.

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

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a high level of violence between the Palestinians and Israel, which has strained Israel's relationship with its Arab citizens, Arab countries and, to some extent, other countries around the world. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. In 2011 and 2012, riots and popular uprisings in several countries in the Middle East have led to severe political instability in those countries. This instability may lead to deterioration of the political and trade relationships that exist between Israel and some of these countries. In addition, this instability may affect the global economy and marketplace. We do not believe that the political and security situation has had a material impact on our business to date; however, there can be no assurance that this will be the case for future operations. We could be adversely affected by any major hostilities, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant downturn in the economic or financial condition of Israel or a significant increase in the rate of inflation. Furthermore, several countries restrict business with Israel and Israeli companies, and additional countries or companies may restrict doing business with Israel and Israeli companies as the result of the aforementioned hostilities. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

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

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

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

Most of our revenues worldwide are denominated in U.S. dollars or are dollar-linked. The substantial portion of our expenses is incurred in U.S. dollars, but we incur a portion of our expenses, principally salaries and related personnel expenses, in other currencies, mainly in Israel - in NIS, in Europe - in Euros and in Asia-Pacific - in several local currencies. If the NIS increases in value relative to the dollar, the dollar cost of our operations in Israel will increase and our dollar-measured results of operations will be adversely affected. In addition, if the Euro increases in value relative to the dollar and sales in Euros do not exceed expenses incurred in Euros, the dollar cost of our operations in Europe will increase and our operating profit will be adversely affected. If the Euro decreases in value relative to the

dollar and sales in Euros exceed expenses incurred in Euros, our operating profit will be negatively affected as a result of a decrease in the dollar value of our sales. If the dollar decreases in value relative to Chinese, Indian, Australian and/or Japanese currencies, the dollar cost of our operations in Asia-Pacific will increase and our operating profit will be negatively affected. For example, during 2012, the average value of the dollar increased in relation to the NIS and the Euro. As a result, during 2012, we had a decrease in the dollar value of our expenses in Israel, which are mostly denominated in NIS, and in the dollar value of our expenses in Europe, which are mostly denominated in Euro. By contrast, due to the fact that a portion of our sales in Europe are also denominated in Euro, we were negatively impacted by the weakening of the Euro value relative to the dollar during 2012. We cannot provide assurances that we will not be materially adversely affected by exchange rate fluctuations in the future. See also "Currency exchange rates and fluctuations of exchange rates could have a material adverse effect on our results of operations" above in this section.

We have obtained substantial benefits from the Israeli Office of Chief Scientist, which subjects us to ongoing restrictions. In addition, these benefits may not continue or in the future may be limited or restricted.

We have in the past received, and may in the future apply for, royalty-bearing or non-royalty-bearing grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor (the “Chief Scientist”) for research and development programs that meet specified criteria. The terms of the Chief Scientist grants limit our ability to manufacture products or transfer technologies outside of Israel if such products or technologies were developed using know-how developed with or based upon Chief Scientist grants. In addition, any non-Israeli who becomes a holder of 5% or more of our share capital or voting rights, is entitled to appoint one or more of our directors or our chief executive officer (including by way of holding 25% or more of the voting power, equity or the right to nominate directors in such direct holder), or is serving as one of our directors or as our chief executive officer, is required to notify the Chief Scientist and to undertake to observe the law governing the grant programs of the Chief Scientist, the principal restrictions and penalties of which are the transferability limits described above.

Further, the Chief Scientist grants may be terminated in the future or the available benefits may be reduced or impacted, including, among other possible circumstances, should we transfer certain research and development and/or manufacturing activities outside the State of Israel. The termination or curtailment of these programs or the loss or reduction of such benefits could have a material adverse effect on our business, financial condition and results of operations.

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

We have in the past benefited, and currently benefit from certain government programs and certain tax benefits in Israel. To remain eligible to obtain such tax benefits, we must continue to meet certain conditions. If we fail to comply with these conditions in the future, the benefits we receive could be canceled and we may have to pay certain taxes or refund payments previously received under these programs (with interest and linkage differentials). We cannot guarantee that these programs and tax benefits will be continued in the future, at their current levels or at all. If these programs and tax benefits are ended, our tax expenses and the resulting effective tax rate reflected in our financial statements may increase and as such our business, financial condition and results of operations could be materially and adversely affected.

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

We are incorporated under the laws of the State of Israel. Service of process upon us, our Israeli subsidiaries, our directors and officers and the Israeli experts, if any, named in this annual report, substantially all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, because the majority of our assets and investments, and substantially all of our directors, officers and such Israeli experts are located outside the United States, any judgment obtained in the United States against us or any of them may be difficult to collect within the United States.

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

procedure will also be governed by Israeli law.

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

- subject to limited exceptions, the judgment is final and non-appealable;
- the judgment was given by a court competent under the laws of the state of the court and is otherwise enforceable in such state;
- the judgment was rendered by a court competent under the rules of private international law applicable in Israel;
- the laws of the state in which the judgment was given provide for the enforcement of judgments of Israeli courts;
- adequate service of process has been effected and the defendant has had a reasonable opportunity to present his arguments and evidence;
- the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties; and
- an action between the same parties in the same matter was not pending in any Israeli court at the time the lawsuit was instituted in the U.S. court.

#### ITEM 4. INFORMATION ON THE COMPANY

##### A. History and Development of the Company

Radware Ltd. was organized in May 1996 as a corporation under the laws of the State of Israel and commenced operations in 1997. Our principal executive offices are located at 22 Raoul Wallenberg Street, Tel-Aviv 69710, Israel and our telephone number is 972-3-766-8666. Our website address is [www.radware.com](http://www.radware.com) (information contained on our website is not incorporated herein by reference and shall not constitute part of this annual report).

As of September 1, 1998, we established Radware, Inc., a wholly-owned subsidiary in the United States, which conducts the sales and marketing of our products in the Americas and is our authorized representative and agent in the United States. The principal offices of Radware Inc. are located at 575 Corporate Dr., Lobby 2, Mahwah, NJ 07430 and its telephone number is 201-512-9771. We also have several wholly-owned subsidiaries world-wide handling local support and promotion activities.

In September 1999, we conducted the initial public offering of our ordinary shares and our ordinary shares commenced trading on the NASDAQ. In January 2000, we completed a secondary public offering.

In December 2005, we acquired the business of V-Secure, which included the acquisition of IP, technology, customers' relationship and goodwill. In April 2007, we acquired Covelight, a U.S.-based company providing web channel intelligence technology, which added enhanced capabilities to our portfolio. In March 2009, we completed the acquisition of Nortel's Layer 4-7 application delivery business. In February 2013, we acquired Strangeloop, a Canadian-based provider of Web performance acceleration solutions. See "Item 5A—Operating and Financial Review and Prospects—Operating Results." Each of these acquisitions has added enhanced capabilities to our business.

For a discussion of our capital expenditures and divestitures, see "Item 5B—Operating and Financial Review and Prospects – Liquidity and Capital Resources."

##### B. Business Overview

###### General

Our products and activities are focused on delivering availability, performance and security to enterprises' and carriers' data centers.

We develop, manufacture and market integrated networking solutions that allow our enterprise and carrier customers to deliver their mission critical applications successfully between data centers and remote locations, over all critical points in the network.

This market sector is comprised of a few solution domains, among which we focus on the following two domains:

- The Application Delivery solution domain consists of the following domains:

- o Server Load Balancing – relative simple deployments of application delivery controllers using basic Layer 4-7 switching functions targeted at SME (small-medium enterprises) market;
- o Advanced Application Delivery – advanced deployment of application delivery controllers using a wider range of advanced capabilities targeted at the medium to large enterprise market;
- o Virtual Application Delivery Infrastructure (VADI) - using virtualization of the application delivery controller, together with advanced APIs into data center management systems this solution enable consolidation of ADC



- appliances, creation of agile ADC Fabric and better integration into virtual and cloud data centers; and
- o Wide Area Network (WAN) link/path load balancing targeted at both SME and larger enterprises

The Application Delivery solution domain is also referred to by select industry analysts as the Application Acceleration market. Our Application Delivery product portfolio consists of advanced application delivery platforms, which offer, in addition to Layer 4-7 switching, benefits in terms of business continuity and resiliency, agility and efficiency by optimizing the delivery of business applications across IP global networks. Among others, our products offer sophisticated features, including Web application firewall, Global Traffic redirection, ADC virtualization, Session Initiation Protocol (SIP) Load Balancing, Application Program Interfaces (APIs), advanced Web Performance Optimization, Application Performance Monitoring and content transformation, all of which are designed to meet complex networking infrastructure and data center demands.

- The Network Security solution domain is more diffuse and consists of firewall/Virtual Private Networks (VPN), Unified Threat Management (UTM), intrusion detection systems, intrusion prevention systems, network behavioral analysis (NBA) systems and Secure Sockets Layer/ Internet Protocol Security (SSL/IPSec) VPN appliances. Our proprietary offering to this domain focuses on attack mitigation systems, which are in-line devices that monitor network and/or system activities for malicious or unwanted behavior and can react, in real-time, to block or prevent those activities.

Our Application Delivery and Network Security solutions enable customers to manage their network infrastructure, bypass systems failures, enable systems availability even under attacks, scale their application performance and secure their Internet protocol (“IP”) traffic. In addition, our solutions enable our customers to pay for the exact capacity they need, eliminate the risks of capacity planning and scale and pay as they grow without having to replace the devices. Our solutions help customers increase business continuity, enhance their business agility, save capital and operating expenditures, improve productivity and extract the greatest value from investments in network infrastructures.

Over the years, our products have won a number of awards for performance, including the following recognition and awards:

- Radware ADC Fabric™ – Winner Bronze Stevie New Product/Service of the Year - B2B Products (2012)
- AMS – Winner, Cloud Computing Excellence Award (2012); Winner, Internet Telephony Excellence Award (2012); Winner, TMC Labs Innovation Award (2012)
  - Radware’s Virtualization Solutions – Winner, NGN Leadership Award (2012)

All of our products are Underwriters Laboratories (UL) and ISO 9001:2000 Quality of Management compliant. Some of our products have also achieved significant industry certification, including:

- the Common Criteria Evaluation & Validation Scheme (CCEVS) EAL4+ through the National Security Agency (NSA) program;
  - FIPS 140-2 through the National Institute of Standards (NIST); and
  - NEBS Level 3 certification.

In addition, we have been recognized in our respective markets by independent, third-party IT analysts such as Forrester Research, Frost & Sullivan, IDC and Yankee Group and as a market leader in the application delivery market by Gartner.

During 2012, our key activities regarding our product offering consisted of the following:

- We continued our investment in our Virtual Application Delivery Infrastructure (VADI®) offering by enhancing the ADC platform offering so that it can be virtualized, extending integration into more virtualization environments and advancing the integration into data center management systems. These activities caused VADI to evolve into an extensive ADC fabric that is an optimal fit into virtual and cloud based data centers.
- We significantly enhanced our Alteon 10000 chassis base solution conforming to the ATCA Telecom standards, delivering OnDemand Hardware scalability for high-end enterprises and carriers requiring an ADC solution with up to 80Gbps of throughput with application acceleration capabilities and delivering 256 virtual ADC on a single Alteon 10000 system, delivering the highest density in the ADC industry and the best Return-on-Investment for datacenter consolidation.



- We continued our investments in the Alteon VA, a SoftADC virtual Appliance, by adding and extending support for Server Virtualization Infrastructure environments, including VMWare Inc. - vSphere, RedHat Inc. – KVM and OpenXen. Alteon VA offering is primarily targeted to cloud providers with high scale ADC requirements in a multi-tenant service environment.
- We continued our investments in our vDirect solution, by delivering tighter integration of our VADI solution and our Alteon VA with Cloud providers provisioning and management systems.
- We released a FIPS 140-2 compliant solution for the highly secure and regulated financial and government markets.
- We continued our investment in our next generation central management system, APSolute Vision, which offers a modern concept and a highly usable user interface, thereby allowing our customers to centrally manage our Appliance base products.
- We extended our Vision support with our AppShape technology facilitating quick deployment and on-going operations of leading enterprise Applications.
- We continued our investment in product developments for the carrier sector with the Alteon product and released major enhancements addressing the Mobile Service Edge (MSE) infrastructure servers scalability and availability requirements by supporting various mobile and fixed infrastructure applications and service needs. We also invested in our SIPDirector® and CID® 3.0 line of products for this market segment.
  - We have introduced DefensePro x420, our next-generation hardware platform in our flagship DefensePro application security suite. With the ability to handle 25 million packets per second of attack traffic, regardless of packet size, as well as up to 40Gbps of legitimate traffic, DefensePro x420 currently offers what we believe to be the world's highest mitigation capacity and is designed to protect organizations from the industry's highest volume denial-of-service (DoS) and DDoS attacks.

## Products and Services

We sell application delivery and network security products, which we sometimes refer to as our devices, that are delivered on top of a unified hardware switching platforms family (OnDemand Switch series) with various levels of processing power, throughput, port density, and speed depending on the selected model. Our products run different configurations of embedded software to deliver features specific to the intended operation of the appliance. Multiple Radware devices can be managed through our common management tool and dashboard (Apsolute Vision).

## Products

Radware's product offering consists of the following product families:

### Application Delivery

- Alteon® Application Switch Application Delivery Controller delivers a reliable Layer 4-7 switching and operation simplicity. Built around the patented, distributed processing Virtual Matrix scalable architecture, these switches provide uncompromising performance and value. Alteon Application Switch supports local, global and transparent load-balance and Application Acceleration as well as multi-homing network load-balance and bandwidth management capabilities. Alteon ADC-VX enhances the Alteon Application Switch with the ability to run multiple Virtual ADC instances (vADC) on the same ADC physical OnDemand Switch Hardware appliance, allowing our customers to consolidate multiple Physical ADC on a single Alteon ADC-VX. ADC-VX is designed from the ground up to enable organizations to consolidate their ADC hardware devices without compromising resiliency or

performance predictability of their ADC services - resulting in significant savings of hardware costs and operational expenses. Additionally, ADC-VX provides the agility and the simplicity that is required in the dynamic virtualized data center, driving faster deployment of new applications and services.

Alteon VA (a SoftADC virtual Appliance) runs Alteon application delivery software on top of general purpose server hardware. Alteon VA features complete feature parity with our hardware appliances vADCs, which enables full flexibility in application deployment models, expedite application roll out and support the full application lifecycle.

Our Alteon product portfolio includes (1) the Alteon 10000 chassis base solution conforming to the ATCA Telecom standards, delivering OnDemand Hardware scalability for high-end enterprises and carriers requiring an ADC solution with up to 80Gbps of throughput with up to 256 vADCs (2) the Alteon 5224 platform, featuring OnDemand scalability from 1Gbps to 16Gbps with up to 24vADCs, and (3) the Alteon 5412 featuring OnDemand scalability from 8Gbps to 20Gbps with up to 28vADC, (4) Alteon 4408 featuring OnDemand scalability from 1Gbps to 4Gbit and (5) Alteon VA featuring OnDemand scalability from 200Mbit to 1Gbit.

#### Virtual Application Delivery Infrastructure Architecture

Our Virtual Application Delivery Infrastructure (VADI) architecture, which transforms computing resources, ADC and virtualization services into an integrated, agile and scalable on-demand application delivery infrastructure, is designed to bridge the underlying hardware resources and cater to the various application needs in terms of service level agreements (SLAs) and performance predictability, while delivering agility to the application delivery space. Our VADI transforms standard application delivery infrastructure into a virtual application delivery control plane, enabling easy and simple migration between the different ADC form factors, according to the dynamic performance needs of applications.

- AppDirector® Intelligent Application Delivery Controller (ADC) ensures a reliable, fast and secure delivery of mission critical data center applications, eliminating the costs of application downtime and service degradation while enhancing productivity. AppDirector provides for data center optimization with advanced Layer 4-7 policies and granular packet classification in order to eliminate traffic surges, server bottlenecks, connectivity disconnects and downtime for ensured business continuity. AppDirector also improves the response time of applications with several technologies for web compression, caching, content acceleration, offloading intensive tasks from servers and optimizing bandwidth consumption.

#### Application Delivery Firewall/Gateway

- AppXML® provides secure, high-performance XML and web services communications for Service Oriented Architecture (SOA) based mission-critical applications between an enterprise and its business partners.

#### Multi-homing solutions

- LinkProof® manages multiple wide area networks (WAN) and Internet traffic for networks, commonly referred to as multi-homed networks, which access the Internet through multiple connections via several Internet Service Providers, to provide fault tolerant, optimized performance and cost effective WAN connectivity.

#### Carrier solutions

- CID - Content Inspection Director® is our transparent, smart redirection and dynamic policy enforcement device and is designed to meet contemporary carrier needs. Using a deep packet/flow inspection (DPI/DFI) engine, CID enables carriers and service providers to provide fast time-to-market and value-added service deployments.
- SIP Director® is a comprehensive Session Initiation Protocol (SIP) SIP-aware application delivery controller for application vendors, telecom equipment manufacturers (TEMs) and system integrators (SIs). SIP director ensures the delivery of a reliable, fast and secure SIP service in a cost effective manner.

Attack Mitigation Solutions (AMS)

- DefensePro® is a real-time network attack prevention device that protects the user's application infrastructure against network and application downtime, application vulnerability exploitation, malware spread, network anomalies, information theft and other emerging network attacks at up to 40-Gigabit speeds.
- AppWall® is a web application firewall (WAF) appliance that secures web applications. It enables Payment Card Industry (PCI) compliance by mitigating web application security threats and vulnerabilities to prevent data theft and manipulation of sensitive corporate and customer information. AppWall incorporates advanced, patent-protected web application security filtering technologies to effectively detect threats, block attacks and report events.

## Real-Time Intelligence

- Inflight™ is a hardware device that provides online, network-based pervasive monitoring solutions that deliver actionable, real-time business-level events to any back-end analytic system to optimize business processes and ensure compliance.

## OnDemand Switch Platforms

Radware's APSolute product suite is powered by the OnDemand Switch®, our hardware platform, which provides high performance and on-demand throughput and service scalability. Based on its "scale-as-you-grow" approach, no forklift upgrade is required even when there are new business requirements. Customers only pay for the exact capacity currently required. Throughput capacity, application-aware services or applications acceleration services can be scaled on-demand to meet new or changing application infrastructure needs. The advantages to this on-demand approach are short-term and long-term savings on CAPEX and OPEX for full investment protection without a compromise on performance.

Our products are compatible with any system that uses the IP and can operate with various network structures, configurations and operating systems. Our products support a wide variety of IP-based applications, including web services, e-mail, voice, Peer to Peer (P2P), Enterprise Resource Planning (ERP), Customer Relationship Management (CRM), network applications such as Domain Name System (DNS), Remote Authentication Dial-In User Service (RADIUS), Dynamic Host Configuration Protocol (DHCP), mobile value added services such as Short Message Service (SMS), Multi Media Message Service (MMS), Wireless Application Protocol (WAP), and many others.

## Management Solutions

APSolute Vision is the management and monitoring solution for our family of application delivery and security solutions. It permits the setup, configuration and management of all our products from one central unified console. As the central element for the entire product suite, APSolute Vision provides immediate visibility to health, real-time status, performance and security of enterprise-wide application delivery and network and application security infrastructures. This enables configuration and true performance management, along with advanced monitoring and reporting capabilities, as well as full visibility into the customer's network security. It lets network administrators proactively monitor network activity and tune network behavior by quickly detecting, isolating and resolving problems before they impact user and business productivity. These capabilities do not rely on any specific middleware, software or custom code.

Our vDirect plug-in is the industry's first ADC management orchestration plug-in, designed specifically for virtual data centers. It provides all the building blocks, and management interfaces required for an Orchestration System to provision, decommission, configure and monitor our VADI vADCs and computing resources within a virtual data center.

This integration allows all of our vADCs to be centrally managed and to take part in virtual data center day-to-day operations and workflow automation, thus unleashing the full agility of complete application services and end-to-end service creation.

## Services

Radware's service offering consists principally of the following services:

### Security Update Service



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

#### Emergency Response Team (ERT) Service

Our Emergency Response Team (“ERT”) service is designed to provide 24x7 security services for customers facing a DoS attack or a malware outbreak. Often, these attacks require immediate assistance. The ERT provides instantaneous expert security assistance in order to restore network and service operational status. The ERT is staffed by experts that have vast knowledge and experience with network threats, their detection and mitigation, and in-depth experience of the DefensePro family of products. In addition, the ERT takes learning from each customer engagement and simulates the same scenario internally for further analysis and proactive implementation of defense techniques for other customers that may face a similar security threat.

## DefensePipe

DefensePipe, launched in early 2013, is an integrated and comprehensive solution to help mitigate volumetric DDoS attacks which threaten to saturate a customer's Internet pipe, or the 'outside line' that connects enterprises to the web. It provides a solution for end to end attack mitigation on-premise and in the cloud. Available to our customers that currently deploy an on-premise Attack Mitigation System (AMS), it is a scalable solution that automatically engages once the customer's AMS detects that pipe saturation is imminent. The sharing of behavioral base line data between the on-premise AMS and DefensePipe, that includes a real-time signature created by the AMS, enables DefensePipe to start mitigation in the cloud much faster and with greater accuracy. The organization's suspicious Internet traffic is immediately diverted to the DefensePipe cloud based scrubbing center where it is distanced further from the protected network and its scalable resources can mitigate high volume attacks. Once the traffic is "cleaned" it is then sent back to the organization and regular operations continue once the attack has ceased.

## Customers and End-Users

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

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

In 2012, approximately 31% of our sales were in the Americas (principally in the United States), 30% were in EMEA (Europe, Middle East and Africa) and 39% in Asia-Pacific, compared to 26%, 35% and 39%, respectively, in 2011, and 28%, 31% and 41%, respectively, in 2010. The United States accounted for 22%, 20% and 20% of our revenues for the years ended December 31, 2012, 2011 and 2010, respectively. China accounted for 11%, 11% and 10% of our revenues for the years ended December 31, 2012, 2011 and 2010, respectively. Other than the United States and China, which accounted for 22% and 11%, respectively, of our total revenues in 2012, no other single country accounted for more than 10% of our sales for 2012.

In 2012 approximately 63% of our sales derived from product sales and 37% derived from service sales, compared to approximately 62% and 38%, respectively, in 2011 and 2010. For the years ended December 31, 2012, 2011 and 2010, no single customer accounted for more than 10% of our sales. As of December 31, 2012, 2011 and 2010, no single customer represented more than 10% of the trade receivables balance.

For additional details regarding the breakdown of our revenues by geographical distribution and by activity, see "Item 5A – Operating and Financial Review and Prospects – Operating Results".

## Seasonality

Our quarterly operating results have been, and are likely to continue to be, influenced by seasonal fluctuations in our sales and by seasonal purchasing patterns of some of our customers. Some of our customers plan their annual purchasing budget at the beginning of each year which causes operating results in our first quarter of the year to be lower than other quarters. In addition, our operating results in the third quarter tend to be lower than other quarters due to the slowdown in business activities during the summer months in Europe. Furthermore, certain customers of ours tend to make greater capital expenditures towards the end of their own fiscal years, thereby increasing our sales for the fourth quarter.

## Sales and Marketing

**Sales.** We market and sell our products primarily through indirect sales channels that consist of distributors and resellers located in North America, Europe and Asia. In addition, we generate direct sales to select customers mainly in the United States. Our sales channels are supported by our sales managers who are also responsible for recruiting potential distributors and resellers and for initiating and managing marketing projects in their assigned regions. The sales managers are supported by our internal sales support staff that help generate and qualify leads for the sales managers. As of December 31, 2012, we employed a total of 163 sales managers and sales staff, of which 57 persons were employed in the Americas with locations in various states. We have subsidiaries and representative offices and branches in several countries, which promote and market our products and provide customer support in their respective regions.

**Marketing.** Our marketing strategy is to enhance brand recognition and maintain our reputation as a provider of technologically advanced, quality Application Delivery and Network Security solutions to help drive demand for our products. We seek to build upon our marketing and branding efforts globally to achieve greater worldwide sales. Our sales force and marketing efforts are principally directed at developing brand awareness, generating demand and providing support to our distributors/resellers to promote sales. We participate in major trade shows, regionally-based events/seminars and offer support to our distributors and resellers who participate in these events. We also invest in online and search engine advertising campaigns, global public relations and regionalized field marketing campaigns. In addition to our independent marketing efforts, we invest in joint marketing efforts with our distributors, value added resellers and other companies that have formed strategic alliances with us.

We have entered into co-marketing arrangements with companies in other complementary sectors in order to broaden our customer base by selling joint solutions comprised of such complementary products. As an example, an applications vendor could sell our AppDirector® to its customers in conjunction with its application in order to load-balance and optimize the application performance. We established such co-marketing arrangements with, among others: Comverse; Hewlett Packard Company; IBM, Inc.; Microsoft Corporation; Oracle Corporation; SAP AG.; Juniper Networks, Inc.; VMWare, Inc.; Red Hat Limited; NEC Corporation; and Verint Americas, Inc. However, there is no assurance that the above co-marketing and strategic alliance agreements would result in a substantial increase in our revenues.

**Strategic Alliances and OEM Agreements.** We have entered into strategic alliances and OEM agreements with other software and hardware vendors, as well as mutual channel information sharing arrangements, where products can either be branded with our name or the vendor's name. We believe that these companies have significant customer relationships and offer products which complement our products. For example, in May 2012, we entered into an agreement with Check Point Software Technologies Ltd., a worldwide leader in Internet security solutions, whereby certain of Check Point's appliances will be based on our Attack Mitigation solutions. We plan to further invest in the development of strategic alliances in order to provide greater access to our target markets and enhance our brand name. We have also entered into OEM agreements with several software vendors, in which we incorporate such vendors' software into our products to create additional value to our customers.

#### Customer Support Services

Our technical team, which consisted of 192 employees worldwide as of December 31, 2012, supports our sales force during the sales process, assists our customers and distributors with the initial installation, set-up and ongoing support of our products, trains distributors and customers to use our products and provides software updates and product upgrades for our products. In addition, our technical team trains and certifies our distributors to provide limited technical support in each of the geographical areas in which our products are sold, and is directly responsible for remote support. Our Certainty Support Program provides offerings which allow customers to automatically obtain new software versions of their products and obtain optimized performance by purchasing any of the following five optional offerings: extended warranty, software updates, 24x7 help-desk (directly to our customers and through our distributors), on-site support and unit replacement. Some of our on-site services are provided by third party contractors.

#### Research and Development

In order to maintain our share of the Application Delivery and Network Security markets, we place considerable emphasis on research and development to expand the capabilities of our existing products, develop new products and improve our existing technologies and capabilities. We believe that our future success will depend upon our ability to maintain our technological expertise, enhance our existing products and introduce, on a timely basis, new commercially viable products that will continue to address the needs of our customers. Accordingly, we intend to

continue devoting a significant portion of our personnel and financial resources to research and development. In order to identify market needs and to define appropriate product specifications, as part of the product development process we seek to maintain close relationships with current and potential distributors, customers and vendors in related industry sectors.

As of December 31, 2012, our research and development staff consisted of 251 employees and 77 subcontractors. Research and development activities take place mainly at our facilities in Israel; Bangalore, India; and North Carolina. We employ established procedures for the required management, development and quality assurance of our new product developments. Our research and development organization is divided into Security, Application Delivery and Management groups. Within those groups the organization is divided according to our existing products. Each product group is headed by a group leader and includes team leaders and engineers. Each group has a dedicated quality assurance team. In addition, we have an infrastructure department responsible for the development of our platforms which are the basis for all products, serving all product groups, which consist of a senior group leader, group leaders, team leaders, and engineers. The heads of all research and development divisions report to the Chief Operating Officer.

### Manufacturing and Suppliers

Our quality assurance testing, packaging and shipping operations as well as part of our final assembly activities are primarily performed at our facility in Jerusalem, Israel.

We rely on third-party manufacturing vendors to provide our finished products. In this respect, Nexcom and Emerson provide us with assembly services in order to deliver the finished goods while we perform the final assembly of the products provided by USR. All components and subassemblies included in our products are supplied to USR, Nexcom and Emerson by several suppliers and subcontractors. Each of USR, Nexcom and Emerson monitors each stage of the components production process, including the selection of components and subassembly suppliers. Thereafter, each of USR, Nexcom and Emerson make the final assembly in their own facility while we perform the final assembly of the products provided by USR in our facilities in Jerusalem. USR is ISO 9002 certified and Nexcom and Emerson are ISO 9001 certified, indicating that each of their manufacturing processes adhere to established quality standards.

USR supplies us with Radware's legacy products. Nexcom provides us with our OnDemand Switch platforms. Emerson is our supplier for the On-Demand Blade Switch Platform and Broadcom supplies us with components for our products.

In 2012, we used Nexcom, USR, Broadcom and Emerson to manufacture our products, purchasing approximately 77%, 9%, 9% and 5% of our products, respectively, from each of those manufacturers. If we are unable to continue to acquire those products from those manufacturers on acceptable terms, or should any of these suppliers cease to supply us with such products for any reason, we may not be able to identify and integrate an alternative source of supply in a timely fashion or at the same costs. Any transition to one or more alternate suppliers would likely result in delays, operational problems and increased costs, and may limit our ability to deliver our products to our customers on time for such transition period, although we believe we have levels of inventory that will assist us to transition to alternate suppliers smoothly.

### Proprietary Rights

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

We have registered trademarks for, among others, "Radware®", "APSolute®", "Web Server Director®", "FireProof®", "LinkProof®", "Triangulation®", "Smart Nat®", "DefensePro®", "StringMatch Engine®", "CID®", "CID – Content Ins Director®", "SIPDirector®", "AppDirector®", "AppXcel®", "AppXML®", "SecureFlow®", "OnDemand Switch®", "App APSolute Insite®", "APSolute Vision®", "vAdapter®", VADI®, "Alteon®" and "ALTEON VA®", and we have trademark applications pending for, among others, "Virtual Director™", "vDirect™", "ADC Fabric™", "Radware ADC Fabric™",

“AppShape™”, “TeraVIP™”, “DefensePipe™” and “DefenseFlow™”. We do not currently own any registered copyrights.

We have registered patents in the United States for, among others, our triangle redirection method used for the global load balancing in our AppDirector product; our mechanism for efficient management and optimization of multiple links used in our LinkProof product; our method for load balancing by global proximity used in our AppDirector product; our method for controlling traffic on links between autonomous BGP systems; the stateful distribution of copied SSL traffic; the transparent inspection of encrypted client traffic; our passive monitoring and event detection mechanisms used for business event monitoring in our Inflight product; the activation of multiple virtual services on a switching platform; the behavioral analysis and detection of zero-day and DoS network attack patterns in our DefensePro product; our hypertext transfer protocol (HTTP) DoS attack mitigation behavioral mechanisms in our DefensePro; a geographically based traffic distribution; a generic proximity based site selection for global load balancing; an internal hardware connectivity plane architecture; and a specific proximity based site selection for global load balancing of HTTP transactions implemented in our Alteon products.

We have pending patent applications and provisional patents in connection with several methods and features used in our products or that we plan to implement in the future. These applications may not result in any patent being issued, and, if issued, the patents may not provide adequate protection against competitive technology and may not be held valid and enforceable if challenged. In addition, other parties may assert rights as inventors of the underlying technologies, which could limit our ability to fully exploit the rights conferred by any patent that we receive. Our competitors may be able to design around a patent we receive and other parties may obtain patents that we would need to license or circumvent in order to exploit our patents.

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

### Competition

The Application Delivery and Network Security markets are highly competitive and we expect competition to intensify in the future. We may lose market share if we are unable to compete effectively with our competitors.

Our principal competitors are:

- in the Application Delivery solutions market: F5 Networks, Inc., Cisco Systems, Inc., Citrix Systems, Inc., A10 Networks, Inc., Brocade Communications Systems, Inc. (Foundry Networks, Inc.) and Riverbed Technology, Inc. (Zeus Technology); and
- in the Network Security space, with respect to our Attack Mitigation Systems, Arbor Networks, Inc., Hewlett Packard, TippingPoint Technologies, Inc., Intel Corporation (McAfee, Inc.) and Sourcefire, Inc.

We expect to continue to face additional competition as new participants enter the market or extend their portfolios into related technologies. Larger companies with substantial resources, brand recognition and sales channels may also form alliances with or acquire competing providers of Application Delivery or Network Security solutions and emerge as significant competitors. For example, Brocade became a competitor in the Application Delivery market by acquiring Foundry Networks in 2009, and, in 2011, Riverbed Technology became a competitor in the Application Delivery market by acquiring Zeus Technology. Competition may result in lower prices or reduced demand for our products and a corresponding reduction in our ability to recover our costs, which may impair our ability to maintain and increase profitability. Furthermore, the dynamic market environment, which is demonstrated by the above acquisitions, poses a challenge in predicting market trends and expected growth.

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



## Government Regulations

### Environmental Regulations

Our activities in Europe require that we comply with European Union Directives with respect to product quality assurance standards and environmental standards. The “RoHs” and RoHs II Directives require products sold in Europe to meet certain design specifications, which exclude the use of hazardous substances. Directive 2002/96/EC on Waste Electrical and Electronic Equipment (known as the “WEEE” Directive) requires producers of electrical and electronic equipment to register in different European countries and to provide collection and recycling facilities for used products. We are currently in compliance with the RoHs and WEEE regulations.

### Israeli Office of Chief Scientist

From time to time, eligible participants may receive grants under programs of the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the Chief Scientist. Grants received are generally repaid through a mandatory royalty based on revenues from the sale of products (and ancillary services) incorporating know-how developed, in whole or in part, with the grants. This governmental support is conditioned upon the participant’s ability to comply with certain applicable requirements and conditions specified in the Chief Scientist’s program and with the provisions of the Law for the Encouragement of Research and Development in the Industry, 1984, as amended, and the regulations promulgated thereunder, or the Research and Development Law.

Under the Research and Development Law, research and development programs that meet specified criteria and are approved by the Research Committee of the Chief Scientist are eligible for grants usually of up to 50% of certain approved expenditures of such programs, as determined by said committee. In exchange, the recipient of such grants is required to pay the Chief Scientist royalties from the revenues derived from products incorporating know-how developed within the framework of each such program or derived therefrom (including ancillary services in connection therewith), up to an aggregate of 100% of the dollar-linked value of the total grants received in respect of such program, plus interest.

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

The Research and Development Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and foreign interested parties to notify the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Chief Scientist to comply with the Research and Development Law. In addition, the rules of the Chief Scientist may require additional information or representations in respect of certain of such events. For this purpose, “control” is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if

such person holds 50% or more of the means of control of a company. “Means of control” refers to voting rights or the right to appoint directors or the chief executive officer. An “interested party” of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 5% or more of our ordinary shares will be required to notify the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research and Development Law.

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

Since 2001, we have not had any liability to pay royalties the Chief Scientist. In addition to grants we received in previous years, which were either fully repaid or non-royalty bearing, we also obtained in 2012, grants from the Chief Scientist to fund certain other research and development projects as part of our participation in the MAGNET Consortium Program. As of December 31, 2012, we received an amount of \$0.3 million through such program and we may receive in the future additional amounts of up to \$0.1 million, subject to our compliance with the terms of the MAGNET Consortium Program. The MAGNET Consortium Program of the Chief Scientist sponsors innovative generic industry-oriented technologies to strengthen the country's technological expertise and enhance competitiveness. These grants do not bear any royalty repayment obligations.

### C. Organizational Structure

We have a wholly-owned subsidiary in the United States, Radware Inc., which conducts the sales and marketing of our products in the United States. We also have subsidiaries in Australia, France, Germany, the United Kingdom, Italy, Japan, Singapore, Korea, Canada, India, Israel, China and Hong Kong, most of which typically conduct the sales and marketing of our products in their respective locations. We have also established a representative office in Taiwan. Our wholly-owned subsidiaries include:

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

\* We own 91% of this subsidiary.

Yehuda Zisapel, one of our co-founders and shareholders, is the Chairman of our Board of Directors and the father of our Chief Executive Officer and President, Roy Zisapel. Individually or together with his brother, Zohar Zisapel, who is also one of our shareholders, Yehuda Zisapel is also a founder, director and/or principal shareholder of several other companies which, together with our Company and our subsidiaries listed above, are known as the RAD-Bynet Group. These companies include, among others:

|                                 |   |                        |
|---------------------------------|---|------------------------|
| AB-NET Communications Ltd.      | Ceragon Networks Ltd.                         | RADWIN Ltd.            |
| BYNET Data Communications Ltd.  | Internet Binat Ltd.                           | SecurityDam Ltd.       |
| BYNET Electronics Ltd.          | Packetlight Networks Ltd.                     | Silicom Ltd.           |
| BYNET SEMECH (outsourcing) Ltd. | RAD-Bynet Properties and Services (1981) Ltd. | Radbit Computers, Inc. |
| Bynet Software Systems Ltd.     | RADCOM Ltd.                                   |                        |
| Bynet System Applications Ltd.  | RAD Data Communications Ltd.                  |                        |
| Chanellot Ltd.                  | Radiflow Ltd.                                 |                        |

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

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

#### D. Property, Plants and Equipment

We operate from leased premises mainly in Tel Aviv and Jerusalem in Israel and New Jersey and North Carolina in the United States. We also lease premises in several locations in Europe and Asia-Pacific for the activities of our subsidiaries, representative offices and branches. Our aggregate annual rent expenses under these leases were approximately \$4.2 million in 2012 compared to \$3.9 million in 2011.

Israel. Our headquarters and principal administrative, finance, research and development and marketing operations are located in approximately 78,000 square feet of leased office space in Tel Aviv, Israel, in three buildings: one, consisting of approximately 36,000 square feet, with a lease expiring in November 2017; the second consisting of 30,000 square feet, with a lease expiring in May 2014; and the third consisting of 12,000 square feet, with a lease expiring in May 2014. These facilities are leased from companies owned by Messrs. Yehuda and Zohar Zisapel. For more information see – “Item 7 - Major Shareholders and Related Parties Transactions.”

In addition, we lease approximately 6,300 square feet of space in Jerusalem for development facilities from a company owned by Messrs. Yehuda and Zohar Zisapel. The lease expires in February 2014. We also sublease approximately 9,700 square feet for warehousing in Jerusalem from an unaffiliated company. For more information, see “Item 7 - Major Shareholders and Related Parties Transactions.”

The aggregate annual rent for the premises in Israel for 2012 was approximately \$1.9 million compared to \$1.6 million in 2011.

Other locations. In the United States, we lease approximately 14,900 square feet of property, consisting of approximately 10,600 square feet of office space and 4,300 square feet of warehouse space, in Mahwah, New Jersey from a company owned by Messrs. Yehuda and Zohar Zisapel. The lease for such property is set to expire in April 2014. For more information, see – “Item 7 - Major Shareholders and Related Party Transactions.”

We lease approximately 3,800 square feet of property for our research and development facilities in North Carolina, the lease for which will expire in September 2018. In addition, we lease approximately 2,350 square feet of property in San Mateo, California. The lease for such property is set to expire in November 2013.

We lease facilities for the operation of our subsidiaries and representative offices in several locations in Europe and Asia-Pacific, all from unrelated third parties.

The aggregate annual rent for our premises located outside Israel was approximately \$2.3 million in 2012 and \$2.3 million in 2011.

Outlook. We believe that the aforesaid offices and facilities are suitable and adequate for our operations as currently conducted and as currently foreseen. In the event that additional or substitute offices and facilities are required, we believe that we could obtain such offices and facilities at commercially reasonable rates.

ITEM 4A.

UNRESOLVED STAFF COMMENTS

None.

ITEM 5.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

A. Operating Results

Overview

General. We are a provider of integrated application delivery and network security solutions, assuring availability, performance and security of business critical networked applications. We began selling our products in 1997, and currently have local offices, subsidiaries or branches in 13 countries in Asia-Pacific, Europe and the Americas.

We sell to a large extent through sales channels such as resellers and distributors. Most of our direct sales are to strategic customers.

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

2012 Highlights. Our operating results in 2012 improved significantly compared to 2011, resulting in operating income of \$30.9 million compared to operating income of \$18.4 million in 2011. The improvement is mainly due to an increase in sales, a slight improvement in our gross margins and our continued control of expenses that resulted in a lower rate of increase in our operating expenses compared to the increase in our sales.

Sales in 2012 were \$189.2 million compared with sales of \$167.0 million in 2011, an increase of 13%. This increase continues the trend of sequential increase in sales year-over-year since our inception and is attributed primarily to the growing demand for our types of products in connection with cloud computing and virtualization trends, growth of mobile data consumption (such as smart-phones, tablet computers and other application based appliances), increased demand for Application Security products (which we believe is associated with the numerous cyber attacks reported in the world media in the past year) and our ability to develop new technologies to address our customers' enhanced network infrastructure and growing needs in terms of complexity, bandwidth and security. According to Gartner estimates, the Application Delivery Controllers market (applicable to our application delivery solutions) has grown in 2012 by 13.2% compared to 2011, and the Intrusion Prevention sector (applicable to our network security solutions) has grown by 6.5% in 2012 compared to 2011, as indicated by Gartner.

Our operating expenses increased 6% in 2012 to \$122.5 million from \$115.2 million in 2011, mainly due to a \$7.1 million increase in selling and marketing expenses associated with an increase in our salary costs, which was due to higher average headcount and salary raises performed in all regions. During 2012, we continued to gradually increase our headcount, mainly in sales and technical support personnel. Our average headcount in 2012 was 771 employees and subcontractors, compared to an average of 724 employees and subcontractors in 2011, an increase of 6%. Since the average number of employees and subcontractors increased, employee related costs also increased in 2012 compared to 2011.

In addition, the net impact of the changes in the average exchange rates of foreign currencies in 2012, compared to 2011, on our operating expenses amounted to a decrease of approximately \$3.4 million. The strengthening of the dollar compared to the NIS and the Euro decreased the dollar value of our operating expenses by approximately \$3.6

million in Israel and Europe. In addition, the weakening of the dollar compared to Asian currencies that occurred in part of 2012 increased the dollar value of our operating expenses in some countries in Asia Pacific by approximately \$0.2 million. The increase in our operating expenses is also due to an increase in other expenses as described in the following paragraphs.

The improvement in our operating results also resulted in net cash generated from operations in 2012 in an amount of \$51.5 million, compared to \$42.0 million in 2011.

**Acquisition of Strangeloop.** In February 2013, we completed the acquisition of Strangeloop, a Canadian-based provider of Web performance acceleration solutions. The total consideration is composed of (1) approximately \$8.4 million in cash payable at closing (subject to certain working capital adjustments) and (2) a milestone-based contingent cash payment of up to \$6.0 million payable by May 1, 2014. Of the initial payment, \$1.5 million was deposited in escrow for two years to secure possible indemnity claims for damages arising out of breaches or inaccuracies of Strangeloop's or Strangeloop shareholders' representations, warranties and covenants, subject to certain limitations. As a result of this transaction, the revenues and expenses of Strangeloop are consolidated with our results of operations starting February 7, 2013.

**Outlook.** The Application Delivery Controllers market, worldwide market revenue is estimated by Gartner to increase to \$1.7 billion during 2013 from \$1.6 billion in 2012, representing an increase of 6.4%. In the Intrusion Prevention sector of the network security market, the market according to Gartner is estimated to increase to \$1.22 billion in 2013 from \$1.18 billion in 2012, representing an increase of 3.7%.

In 2013, we intend to increase our investments in developing new products and enhancing existing products, to support continued growth in our sales and enhancement of market acceptance for our offerings. As a result, we expect our operating expenses to increase as compared to 2012, mainly in research and development and in sales and marketing.

We may also face certain challenges during 2013. Our ability to sustain profitability depends, in part, on the global economy and the growth rates and changes in technology trends in industries in which we operate. In the past year, credit and sovereign debt issues have destabilized certain European economies and thereby increased global macroeconomic uncertainties. As such, our results may be adversely affected if there is a decrease in our revenues due to a further economic slowdown, a decrease in the overall market's IT spending or a reduction in the capital expenditures by companies in our target markets. In addition, our profitability may be adversely affected by fluctuations in currency exchange rates. If the shekel strengthens against the dollar during 2013, the value of our expenses will increase as compared to our revenues, since a large portion of our expenses are paid shekels, whereas most of our revenues are generated in dollars.

#### Critical Accounting Policies

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

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

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



- Revenue recognition;
- Reserve for product return and stock rotation;
- Allowance for doubtful accounts;
- Impairment of marketable securities;

- Goodwill;
- Impairment of long-lived assets and intangible assets;
- Stock-based compensation; and
- Income taxes.

**Revenue Recognition.** We sell products through distributors and resellers which are considered as end users. We recognize product revenue upon delivery, net of estimated returns, provided that persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, and collectability is reasonably assured.

We also sell post-contract customer support ("PCS") elements, which include a limited period of telephone support updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes, rights to upgrades, when and if available, and security update service. Such revenues are recognized ratably over the contract period, which is typically one year to five years.

Revenues in arrangements with multiple deliverables entered into until December 31, 2010 are recognized under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and all other revenue recognition criteria are satisfied.

Starting January 1, 2011 we adopted the guidance of ASU 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB ASC Topic 605, Revenue Recognition) ("ASU 2009-13"). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendment eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. As such, we prospectively applied these provisions to all revenue arrangements entered into or materially modified after January 1, 2011.

We determine the best estimated selling price ("BESP") in multiple-element arrangements as follows:

VSOE for post-contract customer support is determined based on the price charged when such element is sold separately (renewals). The price may vary in the territories and vertical markets in which we conduct business. Price is determined by using a consistent percentage of our product price lists, in the same territories and markets.

For the product, we determine the BESP based on management estimated selling price by considering several external and internal factors including, but not limited to, pricing practices including discounting, margin objectives, and competition. The determination of estimated selling price ("ESP") is made through consultation with and approval of management, taking into consideration the pricing model and go-to-market strategy.

We record a provision for estimated sale returns and stock rotation granted to customers on products in the same period the related revenues are recorded in accordance with ASC No. 605. These estimates are based on historical sales returns, stock rotations and other known factors. Such provisions amounted to \$ 870 and \$ 1,071 as of December 31, 2011 and 2012, respectively.

Deferred revenues include unearned amounts received under post-contract customer support.

**Reserve for Product Returns and Stock Rotation.** In some instances, product revenue from distributors is subject to agreements allowing rights of return and stock rotation. Product returns and stock rotations are estimated based on historical experience and are recorded at the time revenues are recognized. Accordingly, we reduce recognized

revenue for estimated future returns and stock rotations at the time revenue is recorded. When rights of return are present and we cannot estimate returns, revenue is recognized when such rights lapse. The estimates for returns and stock rotations are adjusted periodically based upon changes in historical rates and other related factors. It is possible that these estimates will change in the future or that the actual amounts could vary from our estimates.

Allowance for doubtful accounts. We maintain an allowance for doubtful accounts for losses that may result from the failure of our channel partners to make required payments. We estimate this allowance based on our judgment as to our ability to collect outstanding receivables. We form this judgment based on an analysis of significant outstanding invoices, the age of the receivables, our historical collection experience and current economic trends. If the financial condition of our channel partners were to deteriorate, resulting in their inability to make payments, we would need to increase the allowance for doubtful accounts.

**Impairment of Marketable Securities.** All marketable securities are classified as available-for-sale securities. We assess our available-for-sale marketable securities on a regular basis for other-than-temporary impairment. Pursuant to the accounting guidance in ASC 320 “Investments- Debt and Equity Securities”, if we have a security with a fair value less than its amortized cost and we intend to sell the security or it is more likely than not that we will be required to sell the security before it recovers in value, an other-than-temporary impairment has occurred and we must record the entire amount of the impairment in earnings. If we do not intend to sell the security or it is not more likely than not that we will be required to sell the security before it recovers in value, we must estimate the net present value of cash flows expected to be collected. If the amortized cost exceeds the net present value of cash flows, such excess is considered a credit loss and an other-than-temporary impairment has occurred. The credit loss component is recognized in earnings and the residual portion of the other-than-temporary impairment is recorded in other comprehensive income. The determination of credit losses requires significant judgment and actual results may be materially different than our estimate. We may consider the likely reason for the decline in value, the period of time the fair value was below amortized cost, changes in and performance of the underlying collateral, the ability of the issuer to meet payment obligations, changes in ratings and market trends and conditions.

During the years ended December 31, 2010, 2011 and 2012, no other-than temporary impairments were recorded related to our marketable securities.

**Goodwill.** Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. We review goodwill for impairment at least annually on December 31 or more frequently if events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable in accordance with Accounting Standards Codification (“ASC”) 350 “Intangibles – Goodwill and other.” The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. Only if the carrying amount exceeds its fair value, the second step will be performed. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value. As of December 31, 2012, no impairment of goodwill has been identified.

**Impairment of long-lived assets and intangible assets.** We are required to assess the impairment of tangible and intangible long-lived assets, subject to amortization, under ASC 360 “Accounting for the Impairment or Disposal of Long-Lived Assets”, on a periodic basis, when events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment indicators include any significant changes in the manner of our use of the assets or the strategy of our overall business, significant negative industry or economic trends and significant decline in our share price for a sustained period.

Upon determination that the carrying value of a long-lived asset may not be recoverable based upon a comparison of aggregate undiscounted projected future cash flows from the use of the asset or asset group to the carrying amount of the asset, an impairment charge is recorded for the excess of carrying amount over the fair value. We measure fair value using discounted projected future cash flows. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our tangible and intangible long-lived assets.

We did not record any impairment losses for the years ended December 31, 2010, 2011 and 2012.

**Stock-based compensation.** We account for equity-based compensation in accordance with ASC 718 “Compensation – Stock Compensation.” Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service periods. Determining the fair value of stock-based awards at the grant date requires the exercise of judgment,

including the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ from our estimates, equity-based compensation expense and our results of operations would be impacted.

We estimate the fair value of employee stock options using a Black-Scholes-Merton valuation model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions, including the estimated volatility of our stock price over the expected term of the awards, and the estimated period of time that we expect employees to hold their stock options. The risk-free interest rate assumption is based upon U.S. treasury interest rates appropriate for the expected life of the awards. We use the historical volatility of our publicly traded stock options in order to estimate future stock price trends. In order to determine the estimated period of time that we expect employees to hold their stock options, we use historical behavioral patterns rates of employee groups by job classification. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future. In case of grants having complex vesting terms, we use other models such as the lattice model.

**Income Taxes.** We are subject to income taxes in Israel, the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Based on the guidance in ASC 740 "Income Taxes" we use a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit, the refinement of an estimate or changes in tax laws. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related interest and penalties.

Accounting for tax positions requires judgments, including estimating reserves for potential uncertainties. We also assess our ability to utilize tax attributes, including those in the form of carry forwards for which the benefits have already been reflected in the financial statements. We do not record valuation allowances for deferred tax assets that we believe are more likely than not to be realized in future periods. While we believe the resulting tax balances as of December 31, 2012 and 2011 are appropriately accounted for, the ultimate outcome of such matters could result in favorable or unfavorable adjustments to our consolidated financial statements and such adjustments could be material. See Note 12 to our Consolidated Financial Statements for further information regarding income taxes. We have filed or are in the process of filing local and foreign tax returns that are subject to audit by the respective tax authorities. The amount of income tax we pay is subject to ongoing audits by the tax authorities, which often result in proposed assessments. See "2012 Results of Operations – Taxes" below.

While we believe that we have adequately provided for any reasonably foreseeable outcomes related to tax audits and settlement, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire.

## Results of Operations

The following table sets forth, for the periods indicated, certain financial data concerning our operating results:

|                               | 2010                   | 2011      | 2012      |
|-------------------------------|------------------------|-----------|-----------|
|                               | (U.S. \$ in thousands) |           |           |
| Revenues:                     | \$89,358               | \$103,285 | \$119,279 |
| Products                      | 54,761                 | 63,735    | 69,892    |
| Services                      | 144,119                | 167,020   | 189,171   |
| Cost of revenues:             | 21,306                 | 24,231    | 26,386    |
| Products                      | 7,898                  | 9,126     | 9,333     |
| Services                      | 29,204                 | 33,357    | 35,719    |
| Gross profit                  | 114,915                | 133,663   | 153,452   |
| Operating expenses:           |                        |           |           |
| Research and development, net | 31,660                 | 36,064    | 36,187    |
| Sales and marketing           | 64,609                 | 69,543    | 76,646    |
| General and administrative    | 10,190                 | 9,629     | 9,696     |
| Total operating expenses      | 106,459                | 115,236   | 122,529   |
| Operating income              | 8,456                  | 18,427    | 30,923    |
| Financial income, net         | 2,057                  | 4,200     | 4,792     |
| Income before taxes on income | 10,513                 | 22,627    | 35,715    |
| Taxes on income               | (879 )                 | (1,290 )  | (3,958 )  |
| Net income                    | 9,634                  | 21,337    | 31,757    |

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

|                               | 2010 |   | 2011 |   | 2012 |   |
|-------------------------------|------|---|------|---|------|---|
| Revenues:                     | 62   | % | 62   | % | 63   | % |
| Products                      | 38   |   | 38   |   | 37   |   |
| Services                      | 100  |   | 100  |   | 100  |   |
| Cost of Revenues:             | 15   |   | 15   |   | 14   |   |
| Products                      | 5    |   | 5    |   | 5    |   |
| Services                      | 20   |   | 20   |   | 19   |   |
| Gross profit                  | 80   |   | 80   |   | 81   |   |
| Operating expenses:           |      |   |      |   |      |   |
| Research and development, net | 22   |   | 21   |   | 19   |   |
| Sales and marketing           | 45   |   | 42   |   | 41   |   |
| General and administrative    | 7    |   | 6    |   | 5    |   |
| Total operating expenses      | 74   |   | 69   |   | 65   |   |
| Operating income              | 6    |   | 11   |   | 16   |   |
| Financial income, net         | 1    |   | 3    |   | 3    |   |
| Income before taxes on income | 7    |   | 14   |   | 19   |   |
| Taxes on income               | (1 ) |   | (1 ) |   | (2 ) |   |
| Net income                    | 6    | % | 13   | % | 17   | % |

Revenues.

Our revenues are derived from sales of our products and from sales of post-contract customer support through our Certainty Support program. We generally recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, no further obligation exists and collectability is probable. Post-contract customer support, which represents mainly software update subscriptions, help-desk support and unit repairs or replacements, is recognized ratably over the contract period.



We operate in one reportable market segment and our revenues are attributed to geographic areas based on the location of the end-users.

The following table provides a breakdown of our revenues by type of revenues both in dollars and as a percentage of total revenues for the years ended December 31, 2010, 2011 and 2012:

|          | 2010                  |     |   | 2011                  |     |   | 2012                  |     |   | %<br>Change<br>2012<br>vs.<br>2011 | %<br>Change<br>2011<br>vs.<br>2010 |
|----------|-----------------------|-----|---|-----------------------|-----|---|-----------------------|-----|---|------------------------------------|------------------------------------|
|          | (\$U.S. in thousands) |     |   | (\$U.S. in thousands) |     |   | (\$U.S. in thousands) |     |   |                                    |                                    |
| Products | 89,358                | 62  | % | 103,285               | 62  | % | 119,279               | 63  | % | 15                                 | %                                  |
| Services | 54,761                | 38  | % | 63,735                | 38  | % | 69,892                | 37  | % | 10                                 | %                                  |
| Total    | 144,119               | 100 | % | 167,020               | 100 | % | 189,171               | 100 | % | 13                                 | %                                  |

The following table shows a breakdown of our total revenues by geographical distribution both in dollars and as a percentage of total revenues for the years ended December 31, 2010, 2011 and 2012:

|   | 2010                            |                    |   | Year Ended December 31,<br>2011 |                    |   | 2012                            |                    |   |
|---|---------------------------------|--------------------|---|---------------------------------|--------------------|---|---------------------------------|--------------------|---|
|   | (in<br>thousands<br>of U.S. \$) | (by<br>percentage) |   | (in<br>thousands<br>of U.S. \$) | (by<br>percentage) |   | (in<br>thousands<br>of U.S. \$) | (by<br>percentage) |   |
| North, Central and South America (principally the United States)(*) | 40,492                          | 28                 | % | 43,695                          | 26                 | % | 58,197                          | 31                 | % |
| EMEA (Europe, the Middle East and Africa)                           | 44,231                          | 31                 | % | 57,648                          | 35                 | % | 57,135                          | 30                 | % |
| Asia-Pacific(**)  | 59,396                          | 41                 | % | 65,677                          | 39                 | % | 73,839                          | 39                 | % |
| Total   | 144,119                         | 100                | % | 167,020                         | 100                | % | 189,171                         | 100                | % |

(\*) For the years ended December 31, 2012, 2011 and 2010, our revenues from the United States were \$41.6 million, \$33.9 million and \$28.5 million, respectively, representing 22%, 20% and 20% of total revenues for these years, respectively.

(\*\*) For the years ended December 31, 2012, 2011 and 2010, our revenues from China were \$19.9 million, \$18.5 million and \$14.2 million, respectively, representing 11%, 11% and 10% of total revenues for these years, respectively.

The 15% increase in product sales in 2012 compared to 2011, is attributed to all of our major product lines, in large part as a result of global growth in IT market spending during 2012 and the growing demand for our types of products in connection with cloud computing and virtualization trends, growth of mobile data consumption (such as smartphones, tablet computers and other application based appliances), and increased demand for Application Security products (which we believe is associated with the numerous cyber attacks reported in the world media in the past two years). In 2012, revenues from the enterprise market represented approximately 71% and revenues from the carrier market represented approximately 29% of our total revenues, compared to 72% and 28%, respectively, in 2011. Revenues from services increased by a lower rate of 10% year over year, mainly as a result of lower renewal rate of

our old install base.

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Our revenues in absolute figures increased in the Americas and Asia-Pacific by 33% and 12% year over year, respectively. The EMEA region has experienced a slight decline of less than 1%, mainly due to reduced IT spending in our market which we believe is associated with the economic slowdown in major Western European countries. Revenues from the Americas region have increased at a higher rate than revenues from other regions due to increased demand for our products in the Americas and a higher win rate, in 2012 versus our competition in this region.

Other than the United States and China, which accounted for 22% and 11%, respectively, of our total revenues in 2012, no other single country accounted for more than 10% of our sales for 2012.

The 16% increase in product sales in 2011 compared to 2010, is attributed to all of our major product lines, in large part as a result of the global growth in IT market spending during 2011 and the growing demand for our types of products in connection with cloud computing and virtualization trends, growth of mobile data consumption (such as smart-phones, tablet computers and other application based appliances), and increased demand for Application Security products (which we believe is associated with the numerous cyber attacks reported in the world media in the past year). In 2011, revenues from the enterprise market represented approximately 72% and revenues from the carrier market represented approximately 28% of our total revenues, compared to approximately 75% and 25%, respectively, in 2010. Revenues from services increased in parallel with the increase in product sales (a 16% increase compared to 2010), due primarily to the fact that most of our products are sold with post-contract customer support. Our revenues in absolute figures increased in all regions during 2011 compared to 2010. Revenues from the EMEA region increased by 30% year over year, the Americas by 8% and Asia-Pacific by 11%. Revenues from the EMEA region increased at a higher rate than revenues from the Americas and Asia-Pacific regions due to increased demand for our products in EMEA and a higher win rate versus our competition in this region.

#### Cost of Revenues.

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

The following table sets forth a breakdown of our cost of revenues between products and services for the periods indicated, in absolute figures (dollars in thousands) and as a percentage of the relative revenues:

|                  | 2010     |      |   | 2011     |      |   | 2012     |      |   |
|------------------|----------|------|---|----------|------|---|----------|------|---|
| Cost of Products | \$21,306 | 23.8 | % | \$24,231 | 23.5 | % | \$26,386 | 22.1 | % |
| Cost of Services | 7,898    | 14.4 | % | 9,126    | 14.3 | % | 9,333    | 13.4 | % |
| Total            | \$29,204 | 20.3 | % | \$33,357 | 20.0 | % | \$35,719 | 18.9 | % |

Cost of products sales as a percentage of products sales decreased year-over-year from 23.5% in 2011 to 22.1% in 2012. Cost of products sales in 2012 included amortization of intangible assets in the amount of \$1.9 million, compared to an amortization of intangible assets in the amount of \$2.2 million in 2011. Our cost of products sales as a percentage of products sales, excluding these items, represented approximately 20.6% of products sales in 2012, compared to 21.4% in 2011.

The decrease in cost of products sales as a percentage of products sales is due to the different mix of products sold during 2012 compared to 2011. During 2012, our virtualized solutions became a more significant part of our products sales. Such sales generally have higher gross margins than our regular hardware products sales. Cost of sales related to services as a percentage of service revenues in 2012 was 13.4% compared to 14.3% in 2011. Since a major portion of these costs are fixed costs (mainly salaries of technical personnel), the increase in sales did not correlate into the same

rate of increase in costs.

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Cost of products sales as a percentage of products sales decreased slightly year-over-year from 23.8% in 2010 to 23.5% in 2011. Cost of products sales in 2011 included amortization of intangible assets in the amount of \$2.2 million, compared to an amortization of intangible assets in the amount of \$1.8 million in 2010. Our cost of products sales as a percentage of products sales, excluding these items, represented approximately 21.4% of product sales in 2011, compared to 21.9% in 2010.

The decrease in cost of products as a percentage of products sales is due to the different mix of products sold during 2011 compared to 2010. During 2011, our virtualized solutions became a significant part of our products sales. Such sales generally have higher gross margins than our regular hardware products sales. Cost of sales related to services as a percentage of service revenues in 2011 was 14.3% compared to 14.4% in 2010. Since a major portion of these costs are fixed costs (mainly salaries of technical personnel), the increase in sales did not correlate into the same rate of increase in costs.

#### Operating Expenses.

The following table sets forth a breakdown of our operating expenses (dollars in thousands) for the periods indicated:

|                               | 2010      | 2011      | 2012      | % Change<br>2012 vs.<br>2011 |   | % Change<br>2011 vs.<br>2010 |    |
|-------------------------------|-----------|-----------|-----------|------------------------------|---|------------------------------|----|
| Research and development, net | \$31,660  | \$36,064  | \$36,187  | 0                            | % | 14                           | %  |
| Selling and marketing         | 64,609    | 69,543    | 76,646    | 10                           | % | 8                            | %  |
| General and administrative    | 10,190    | 9,629     | 9,696     | 1                            | % | (6)                          | )% |
| Total                         | \$106,459 | \$115,236 | \$122,529 | 6                            | % | 8                            | %  |

#### Research and Development Expenses.

Research and development, or R&D, expenses consist primarily of salaries and related personnel expenses, costs of subcontractors and prototype expenses related to the design, development, quality assurance and enhancement of our products, and depreciation of equipment purchased for the development and testing processes. All R&D costs are expensed as incurred. We believe that continued investment in R&D is critical to attaining our strategic product objectives.

R&D expenses were \$36.2 million in 2012, an increase of only \$0.1 million compared with research and development expenses of \$36.1 million in 2011. This slight increase is a result of the following: (1) an increase of \$1.6 million from a higher average number of R&D employees and subcontractors, as well as salary raises performed in June 2012, (2) a \$0.3 million increase in overhead mainly associated with the increase in the number of our employees, and (3) an increase in depreciation expenses of approximately \$0.3 million related to lab and testing equipment purchased in the last 2 years. Such increase was partially offset by (1) grants in an amount of \$0.3 million from the Chief Scientist received during 2012, and (2) a decrease of approximately \$1.8 million from the strengthening of the dollar against the NIS during 2012 compared with 2011. Excluding the exchange rates effect, we expect our R&D expenses in 2013 to be higher than in 2012, mainly due to an expected increase in the number of employees in research and development positions.

R&D expenses were \$36.1 million in 2011, an increase of \$4.4 million, or 14%, compared with research and development expenses of \$31.7 million in 2010. This increase was primarily attributable to (1) an increase of \$2.8 million from a higher average number of R&D employees, including subcontractors and consultants which assist and promote certain R&D projects, as well as salary raises performed in April 2011, (2) a \$0.3 million increase in travel

costs and overhead associated with the increase in the number of our employees, (3) an increase of approximately \$0.9 million from the weakening of the dollar against the NIS during 2011 compared with 2010, and (4) an increase of \$0.5 million from an increase in depreciation, mainly in relation with material purchases of lab equipment in the past two years. Stock-based compensation expenses decreased by \$0.1 million. See also “Stock based compensation expenses”, below.

### Sales and Marketing Expenses.

Sales and marketing expenses consist primarily of salaries, commissions and related personnel expenses for those engaged in the sales and marketing of our products, operational costs of our offices which are located outside Israel and are engaged in the promotion, marketing and support of our products, in addition to the related trade shows, advertising, promotions, web site maintenance and public relations expenses, and amortization of intangible assets.

Sales and marketing expenses were \$76.6 million in 2012, an increase of \$7.1 million, or 10%, compared with sales and marketing expenses of \$69.5 million in 2011. Intangible assets amortization expenses in 2012 decreased in an amount of \$0.5 million from \$1.7 million in 2011 to \$1.2 million in 2012. Excluding these amortization expenses, sales and marketing expenses increased by \$7.6 million, of which (1) \$6.5 million was attributable to an increase in the average number of sales, technical support and marketing employees in the United States, EMEA and Asia Pacific regions as well as recruiting expenses and salary raises performed in the beginning of 2012 to some of our employees, (2) \$0.7 million relates to higher travel costs and overhead associated with the increase in the number of our employees, (3) \$1.1 million relates to the increase of our marketing expenses, mainly related to trade shows, events and seminars, (4) \$0.2 million was attributed to an increase in stock-based compensation expenses. See also “Stock based compensation expenses”, below, and (5) an increase in depreciation expenses of approximately \$0.3 million, mainly in relation with purchases of demo equipment during the past two years. The net impact of the strengthening of the dollar compared to the NIS and Euro and the weakening of the dollar compared to most Asian currencies offset the increase in our selling and marketing expenses by \$1.2 million. For a discussion of the impact of foreign currency fluctuations on our business, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk”.

Excluding the effect of exchange rates, we expect our sales and marketing expenses in 2013 to be higher than in 2012, mainly due to the increase in the number of our employees engaged in marketing and sales positions and marketing activities to promote our new and improved products.

Sales and marketing expenses were \$69.5 million in 2011, an increase of \$4.9 million, or 8%, compared with sales and marketing expenses of \$64.6 million in 2010. Intangible assets amortization expenses in 2011 decreased in an amount of \$0.5 million from \$2.2 million in 2010 to \$1.7 million in 2011. Excluding these amortization expenses, sales and marketing expenses increased by \$5.4 million, of which (1) \$2.0 million was attributable to an increase in the average number of sales, technical support and marketing employees in EMEA and the United States, as well as salary raises performed in the beginning of 2011 to some of our employees, (2) \$1.4 million was the net impact of the weakening of the dollar compared to the NIS and Euro and Asian currencies, (3) \$0.5 million of the increase was attributed to higher travel costs and overheads associated with the increase in the number of our employees, (4) \$0.8 million of the increase was attributed to an increase in stock-based compensation expenses due to the increase in our average share price in 2011 compared to 2010, as explained below under “Stock based compensation expenses”, and (5) an increase in depreciation expenses of approximately \$0.7 million, mainly in relation with purchases of demo equipment during the past two years.

### General and Administrative Expenses.

General and administrative expenses consist primarily of salaries and related personnel expenses for executive, accounting and administrative personnel, professional fees (which include legal, audit and additional consulting fees), bad debt expenses, acquisition related costs and other general corporate expenses.

General and administrative expenses were \$9.7 million in 2012, an increase of \$0.1 million, compared with general and administrative expenses of \$9.6 million in 2011. General and administrative expenses in 2012 included stock-based compensation expenses of \$0.9 million, compared to stock-based compensation expenses of \$1.1 million in 2011. Excluding stock based compensation expenses, the general and administrative expenses in 2012 totaled \$8.8

million, compared to \$8.5 million in 2011. Of these expenses, (1) \$0.4 million was attributable to an increase in the average number of general and administrative employees and salary raises to our employees, (2) \$0.4 million relates to the increase in subcontractors' costs incurred in relation with the maintenance of our ERP system, and (3) \$0.1 million relates to an increase in overhead expenses associated to new employees and subcontractors. These increases were partially offset by the decrease in depreciation of \$0.2 million and the impact of the strengthening of the dollar compared to the NIS in the amount of \$0.4 million. The decrease in stock based compensation expenses of \$0.2 million is explained below under "Stock based compensation expenses".



General and administrative expenses were \$9.6 million in 2011, a decrease of \$0.6 million, or 6%, compared with general and administrative expenses of \$10.2 million in 2010. General and administrative expenses in 2011 included stock-based compensation expenses of \$1.1 million, compared to stock-based compensation expenses of \$1.8 million in 2010. Excluding stock based compensation expenses, the general and administrative expenses in 2011 totaled \$8.5 million, compared to \$8.4 million in 2010. Of these expenses, (1) \$0.2 million was attributable to an increase in the average number of general and administrative employees and salary raises to our employees, (2) \$0.2 million was attributed to the impact of the strengthening of the NIS compared to the dollar, and (3) a decrease in bad debt expenses in an amount of \$0.3 million. The decrease of \$0.7 million in stock based compensation expenses was due to a decrease of \$0.3 million in relation to options granted on December 31, 2007 to our CEO (these compensation expenses are recognized over the estimated requisite service period on an accelerated method basis). A decrease in an amount of \$0.2 million was due to cancellation of options granted to one of our subcontractors during 2010, who terminated his service during 2011, and the rest of the decrease was due to higher expiration of stock options in 2011, compared to 2010, in regards to the rest of our employees, which was partially offset due to the increase in our average share price in 2011 compared to 2010, as explained below under "Stock based compensation expenses".

#### Stock based compensation expenses.

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

Our total amount of stock based compensation expenses in 2012 totaled to \$5.4 million, the same as in 2011. Grant date fair values of our equity-based payment awards granted during 2012 increased compared to fair values of awards granted during 2011, due to the increase in our average share price in 2012 compared to 2011 and 2010. However, during 2012 we granted only 0.4 million stock options, compared to 1.0 million in 2011 and 1.1 million in 2010. These two impacts offset each other in 2012.

Grant date fair values of our equity-based payment awards granted during 2011 increased compared to fair values of awards granted during 2010, due to the increase in our average share price in 2011 compared to 2010. Because these values are recognized as an expense based on the accelerated attribution method over the requisite service period of each award, a large portion of these values is being recognized as an expense in the first year since grant date of each award, which resulted in higher stock-based compensation expenses in 2011 compared to 2010.

#### Financial Income, Net.

Financial income, net consists primarily of interest earned on short-term and long-term bank deposits, amortization of premiums, accretion of discounts, interest and dividends earned on investments in marketable securities, and from income and expenses from the translation of monetary balance sheet items denominated in non-dollar currencies.

Financial income, net was \$4.8 million in 2012, compared with \$4.2 million in 2011. An increase of \$ 1.0 million is attributed mainly to an increase of approximately \$52.0 million in our average cash balance (including bank deposits and marketable securities) in 2012 compared to 2011. This increase was offset by a decrease of \$0.4 million which is attributed to the impact of changes in exchange rates in 2012, compared to 2011, which affected the foreign currency translation differences included in our financial income.

Financial income, net was \$4.2 million in 2011, compared with \$2.1 million in 2010. An increase of \$1.1 million is attributed mainly to an increase of approximately \$47 million in our average cash balance (including bank deposits and marketable securities) in 2011 compared to 2010. An increase of \$1.0 million is attributed to the impact of changes in exchange rates in 2011, compared to 2010, which affected the foreign currency translation differences included in our financial income.

#### Income Taxes.

Israeli companies are generally subject to corporate tax on their taxable income at the rate of 24% for the 2011 tax year, 25% for the 2012 tax year and 25% for the 2013 tax year. However, we have established an approved enterprise programs, which are eligible for the tax benefits described below under the heading “Corporate Tax Rate.” These benefits result in part of our income being tax exempt or taxed at a lower rate for some time after we begin to report taxable income. The tax rate depends upon the percentage of our income derived at that time from the approved enterprise and privileged program. The tax benefits depend on our meeting the requirements of the approved enterprise program and there is no assurance that we will be able to obtain such benefits. In addition, our U.S. subsidiary has carry-forward tax losses to offset against future taxable profit. We provided a partial valuation allowance with respect to these carry-forward tax losses due to uncertainty in part of their future utilization. Other subsidiaries of ours are taxed according to the laws in their countries of incorporation and tax expenses are recorded accordingly. We may incur tax expenses in 2013 which we anticipate to be at a rate of up to 12% of our pre-tax income.

We operate our business in various countries and attempt to utilize an efficient operating model to optimize our tax payments based on the laws in the countries in which we operate. This can cause disputes between us and various tax authorities in different parts of the world. In particular:

- in December 2010, following an audit of our Israeli tax returns for the 2004 and 2005 fiscal years, the Israeli Tax Authority (“ITA”) issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 16.1 million (approximately \$4.3 million) for 2004 and NIS 15.5 million (approximately \$4.2 million) for 2005, including interest as of the assessment date; and
- in January 2012, following an audit of our Israeli tax returns for the 2006 and 2008 fiscal years, the ITA issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 25.2 million (approximately \$6.8 million) for 2006 and NIS 8.1 million (approximately \$2.2 million) for 2008, including interest as of the assessment date.

We have appealed the orders relating to the four years mentioned above with the Tel Aviv District court, and these appeals are currently pending. There can be no assurance that the courts will accept our positions on matters raised, and in such an event, we may be required to pay all or a portion of the amounts of these orders. Such a payment could result in a material adverse effect on our business, financial condition and results of operations.

Income taxes were approximately \$4.0 million in 2012 (in and outside Israel), compared with \$1.3 million in 2011. This increase is attributed mainly to the increase in our pre-tax income in 2012 compared to 2011 and due to ASC No. 740 provisions, as well as due to completion of utilizing net operating losses in Israel.

Income taxes were approximately \$1.3 million in 2011 (in and outside Israel), compared with \$0.9 million in 2010. This increase is attributed mainly to the increase in our pre-tax income in 2011 compared to 2010.

For additional disclosure and explanations regarding our income taxes, see note 12 to our financial statements. See also “Item 10E – Taxation – Israeli Tax Considerations.”

#### Impact of Currency Fluctuations

Information required by this section is set forth in “Item 11 – Qualitative and Quantitative Disclosures about Market Risk” and in “Item – 3D – “Risk Factors” –Currency exchange rates and fluctuations of exchange rates could have a material adverse effect on our results of operations”, each of which are incorporated herein by reference.

## Impact of Governmental Policies

For information on the impact of governmental policies on our operations, see “Item 4B – “Government Regulations” and “Item – 3D – “Risk Factors” – “Risks Related to Operations in Israel.”

## B. Liquidity and Capital Resources

## Working Capital and Cash Flows

In our opinion, the Company’s working capital is sufficient for the Company’s present requirements. Since our inception, we have financed our operations through a combination of issuing debt and/or equity securities, including two public offerings, research and development and/or marketing grants from the Government of Israel and cash generated by operations. Capital expenditures for the year ended December 31, 2012, were \$9.3 million and for each of the years ended December 31, 2011 and 2010, was \$5.7 million. These expenditures were mainly comprised of machinery and equipment, computers, lab equipment and testing tools. We expect to engage in additional capital spending to support possible growth in our operations, infrastructure and personnel. In 2013, we anticipate that the majority of our capital expenditures will be primarily for R&D testing and lab equipment.

The following table presents the major components of net cash flows used in and provided by operating, investing and financing activities for the periods presented (dollars in thousands):

|   | 2012      | 2011      | 2010      |
|---|-----------|-----------|-----------|
| Net cash provided by (used in) operating activities | 51,520    | 41,990    | 40,966    |
| Net cash used in investing activities               | (59,886 ) | (49,212 ) | (66,725 ) |
| Net cash provided by (used in) financing activities | 11,028    | 9,324     | 21,200    |

Net cash provided by operating activities for 2012, 2011 and 2010 was \$51.5 million, \$42.0 million and \$41.0 million, respectively. Our net income in 2012, 2011 and 2010 was \$31.8 million, \$21.3 million and \$9.6 million, respectively. Net cash provided by operating activities in 2012 consisted primarily of net income adjusted for non-cash activity, including stock-based compensation expenses, depreciation, amortization of intangible assets, and amortization of premiums, accretion of discounts and accrued interest on available-for-sale marketable securities plus an increase in trade payables and other payables and accrued expenses, partially offset by a decrease in trade receivables and an increase in inventories and deferred income taxes. Net cash provided by operating activities in 2011 consisted primarily of net income adjusted for non-cash activity, including stock-based compensation expenses, depreciation, amortization of intangible assets, and amortization of premiums, accretion of discounts and accrued interest on available-for-sale marketable securities plus decrease in trade receivables and an increase in other payables and accrued expenses, partially offset by an increase in inventories and deferred income taxes. Net cash provided by operating activities in 2010 consisted primarily of net income adjusted from non-cash activity, including stock-based compensation expenses, depreciation, amortization of intangible assets, and amortization of premiums, accretion of discounts and accrued interest on available-for-sale marketable securities plus increase in deferred revenue and other payables and accrued expenses.

Net cash used in investing activities was \$59.9 million for 2012, compared to net cash used in investing activities of approximately \$49.2 million for 2011, and net cash used in investing activities of approximately \$66.7 million for 2010. Cash was used in investing activity in 2012 and in 2011 mainly for purchase of bank deposits, marketable securities and purchase of property and equipment. Cash was used in investing activities identical to 2012. Cash was used in investing activities in 2010 mainly for the purchase of bank deposits, marketable securities and purchase of intangible assets, property and equipment.

Net cash provided by financing activities in 2012 was \$11.0 million, compared to net cash provided by financing activities of \$9.3 million for 2011 and net cash provided by financing activities of \$21.2 million for 2010. The cash provided by financing activities in 2012, 2011 and in 2010 was generated from options exercises by our employees under the Key Employee Share Option Plans and Employee Stock Purchase Plans (see “Item 6E – Directors Senior Management and Employees – Share Ownership - Key Employee Share Incentive Plan and Employee Stock Purchase Plan”) and from adjustment of excess tax benefit from stock based compensation.

As of December 31, 2012, we had cash and cash equivalents, including short-term and long-term bank deposits and marketable securities, of \$274.9 million, compared to \$219.1 million as of December 31, 2011 and \$178.8 million as of December 31, 2010. As of December 31, 2012, approximately 99% of our cash, cash equivalents and marketable securities are held by Radware Ltd. in Israeli or U.S. financial institutions. There are no material legal restrictions, taxes or other costs associated with transferring our funds held in U.S. financial institutions to Israeli financial institutions, and we have access to all of our cash as needed for our operations. Although we have various subsidiaries throughout the world, there are no material legal, tax or other cost impediments to our transferring cash to these subsidiaries for operations as and when needed or to such subsidiaries transferring cash to Radware to meet its own cash obligations. Further, Radware generates sufficient cash from its Israeli operations to fund its operating and capital requirements and, therefore, does not need or intend to repatriate any of the earnings of its foreign subsidiaries.

The days-sales-outstanding (DSO) for a given period is calculated by dividing the end-of-period balance of accounts receivable by the average daily sales in the period. The average quarterly DSO (computed over the four quarters of the year) was 32 days for 2012, compared with 33 days in 2011 and 35 days in 2010. When computed annually, the DSO is 36 days in 2012, compared with 27 days in 2011 and 42 days in 2010.

Our capital requirements depend on numerous factors, including market acceptance of our products and the resources we allocate to our operating expenses. Since our inception, we have experienced substantial increases in our expenditures consistent with growth in our operations and personnel, and we may increase our expenditures in the foreseeable future in order to execute our strategy. In March 2009, we purchased Nortel's Layer 4-7 application delivery business for total consideration of \$18.0 million, with additional transaction related costs of \$2.5 million, and, in February 2013, we purchased Strangeloop for total consideration of \$8.4 million in cash and a milestone-based contingent payment of up to \$6.0 million, with additional transaction related costs of up to \$0.5 million.

We anticipate that operating activities as well as capital expenditures will demand the use of our cash resources. We believe that our cash balances will provide sufficient cash resources to finance our operations and the projected marketing and sales activities and research and development efforts for a period of no less than the next twelve months.

#### Related Parties

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

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

#### Market Risk

We are exposed to market risk, including fluctuations in interest rates and foreign currency exchange rates. Our primary market risk exposure occurs because we generate a portion of our revenues in Euro and incur a portion of our expenses in NIS and in Euro. We do not presently engage in any hedging or other transactions intended to manage

risks relating to foreign currency exchange rate or interest rate fluctuations. Additional information about market risk is set forth in “Item 11 – Qualitative and Quantitative Disclosures about Market Risk” and incorporated herein by reference.

C. Research and Development, Patents and Licenses, etc.

In order to accommodate the rapidly changing needs of our markets, we place considerable emphasis on research and development projects designed to improve our existing product lines, develop new product lines and customize our products to meet our customers' needs. As of December 31, 2012, we had 251 employees and 77 subcontractors engaged primarily in research and development activities, compared to 208 employees and 98 subcontractors at the end of 2011.

For a further discussion of research and development, see "Item 5A – Operating and Financial Review and Prospects – Operating Results."

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

D. Trend Information

For a discussion of recent market trends, see "Item 5A – Operating and Financial Review and Prospects – Operating Results – Outlook."

E. Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as such term is defined under Item 5E of the instructions to Form 20-F, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2012 and the effect those commitments are expected to have on our liquidity and cash flow.

|   | Total | Payments Due By Period (US \$ in thousands) |           |              |                      |
|---|-------|---|-----------|--------------|----------------------|
|   |       | Less than 1<br>year                         | 1-3 years | 3-5<br>years | More than<br>5 years |
| Contractual obligations                   |       |   |           |              |                      |
| Operating leases(1)                       | 4,160 | 2,891                                       | 1,035     | 168          | 66                   |
| Total contractual cash obligations (2)(3) | 4,160 | 2,891                                       | 1,035     | 168          | 66                   |

(1) Consists of outstanding operating leases for the Company's facilities. The lease agreements expire in the years 2013 to 2018, although certain of our leases have renewal options. The data in this row details our future minimum payments under non-cancelable operating lease agreements at December 31, 2012.

(2) Payments for uncertain income tax positions of \$5.7 million under ASC 740 are due upon settlement. Since we are unable to reasonably estimate the timing of settlement, such payments are not included in the table. See also Notes 2(r) and 12(a) of our Consolidated Financial Statements.

(3) Severance payments of \$3.3 million are payable only upon termination, retirement or death of the respective employee and there is no obligation for benefits accrued prior to 2007 if the employee voluntarily resigns. Of this amount, \$0.3 million is unfunded. Since we are unable to reasonably estimate the timing of settlement, such payments



are not included in the table. See also Note 2(t) of our Consolidated Financial Statements.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

## A. Directors and Senior Management

The following table lists our current directors and senior management:

| Name                      | Age | Position  |
|---------------------------|-----|---|
| Roy Zisapel<br>(1)        | 42  | Chief Executive Officer, President and Director     |
| Meir Moshe                | 59  | Chief Financial Officer                             |
| Ilan Kinreich             | 55  | Chief Operating Officer                             |
| Avi Chesla                | 40  | Chief Technology Officer                            |
| Sharon Trachtman          | 46  | VP, Global Marketing                                |
| Yehuda Zisapel (2)        | 71  | Chairman of the Board of Directors                  |
| Yair Tauman (1)(3)(4)(5)  | 64  | Chairman of the Compensation Committee and Director |
| David Rubner (2)(3)(4)(5) | 73  | Chairman of the Audit Committee and Director        |
| Hagen Hultzsich (4)(5)(6) | 72  | Director  |
| Yael Langer (6)           | 48  | Director  |
| Avraham Asheri (2)(4)(7)  | 75  | Director  |

- (1) Term as director expires at the annual meeting of shareholders to be held in 2013.
- (2) Term as director expires at the annual meeting of shareholders to be held in 2015.
- (3) External Director, as defined in the Israeli Companies Law.
- (4) Qualified as an independent director, as determined under the NASDAQ rules.
- (5) Serves on the Audit and Compensation Committees of the Board of Directors.
- (6) Term as director expires at the annual meeting of shareholders to be held in 2014.
- (7) Serves on the Audit Committee of the Board of Directors.

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

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

Ilan Kinreich has served as our Chief Operating Officer since December 2007. From 1993 until 2005, Mr. Kinreich was the founder and CEO of Radview Software Ltd., a company that developed performance testing and management solutions and thereafter, until September 2007, he was its Chief Strategic Officer. From 1989 until 1991 Mr. Kinreich was a co-founder and Vice President R&D of Mercury Interactive. From 1984 until 1989 Mr. Kinreich was R&D

manager at Daisy Systems. Mr. Kinreich began his career in 1977 at the technology units of the Israel Defense Forces where he oversaw the deployment of command and control systems and reached the rank of a Captain. Mr. Kinreich holds a Bs.C. degree in Mathematics and Computer Sciences from Bar-Ilan University, Israel.

Avi Chesla has served as our Chief Technology Officer since August 2011. Prior to that, he led our security division as VP of Security Products since October 2006. Between 2000 and 2005, Mr. Chesla held several senior positions with V-Secure Technologies Ltd., a start-up security solutions company. Mr. Chesla has authored a number of articles for major publications in the areas of advanced network behavioral analysis and information security and has contributed to numerous patents in these areas. Mr. Chesla holds a B.S. degree in physics and mathematics from Tel Aviv University, Israel.

Sharon Trachtman has served as our Global Marketing Vice President since September 2008. Prior to that, since September 1997 she held various senior positions in Radware, such as Product Management Vice President and Marketing Vice President. From November 1994 to September 1997, Ms. Trachtman was a product line marketing manager for Scitex Corporation. Ms. Trachtman holds a B.A. degree in computer science and philosophy from Bar-Ilan University, Israel.

Yehuda Zisapel, co-founder of our Company, has served as a member of our Board of Directors since our inception in May 1996 and served as Chairman of our Board of Directors from May 1996 until August 2006 and again since November 2009. In addition, Mr. Zisapel serves as a director of Radware Inc. and other subsidiaries. Mr. Zisapel is also a founder and a director of RAD Data Communications Ltd., a worldwide data communications company headquartered in Israel, and BYNET Data Communications Ltd., a distributor of data communications products in Israel and serves as a director of other companies in the RAD-Bynet Group. See “Item 4C – Organizational Structure.” Mr. Zisapel has a B.Sc. and a M.Sc. degree in electrical engineering as well as an Award of Honorary Doctorate (DHC-Doctor Honoris Causa) from the Technion, Israel Institute of Technology and an M.B.A. degree from Tel Aviv University, Israel. Yehuda Zisapel is the father of Roy Zisapel, a director and President and Chief Executive Officer of the Company.

Prof. Yair Tauman has served as a member of the Board of Directors since October 2010. He has been the Dean of the Arison School of Business in the Interdisciplinary Center (IDC) in Herzliya, Israel since January 2010 and is also a Professor of Economics and the Director of the Center for Game Theory in Economics at Stony Brook University, New York. His areas of research include game theory and industrial organization. Prof. Tauman currently serves on the board of directors of several companies from different sectors including online auctions, financial information, education and IT, one of which, ADVFN Plc, is traded on the London Stock Exchange. Prof. Tauman obtained his Ph.D. and M.Sc. degrees in mathematics as well as a B.Sc. in mathematics and statistics from The Hebrew University in Jerusalem, Israel.

David Rubner has served as a member of the Board of Directors since October 2009. Mr. Rubner is the Chairman and Chief Executive Officer of Rubner Technology Ventures Ltd., and a Partner in Hyperion Israel Advisors Ltd., a venture capital firm. During the years 1991 to 2000, he was President and Chief Executive Officer of ECI Telecom Ltd. (“ECI”). Prior to that, Mr. Rubner held several senior positions within ECI, such as Chief Engineer, Vice President of Operations and Executive Vice President, General Manager of the Telecommunications division. Prior to joining ECI, Mr. Rubner was a senior engineer in the Westinghouse Research Laboratories in Pittsburgh, Pennsylvania. Mr. Rubner serves on the boards of Check Point Software Ltd., Elbit Imaging, Ltd. and other public and private companies. He also serves on the boards of trustees of Bar-Ilan University, Shaare Zedek Hospital and is Chairman of the Petah Tikva Foundation. Mr. Rubner holds a B.Sc. degree in engineering from Queen Mary College, University of London and an M.S. degree from Carnegie Mellon University.

Dr. Hagen Hultzsich has served as a member of our Board of Directors since January 2005. Dr. Hultzsich served on the Board of Management of Deutsche Telekom AG from 1993 until 2001. Since 2001, Dr. Hultzsich has served on the boards or advisory boards of several companies and academic institutions. Dr. Hultzsich serves as a board member of the T-Systems Solutions for Research GmbH, Zimory AG and others and he is a member of the advisory boards of several private and public technology companies. Dr. Hultzsich holds a PhD. degree in Physics from Mainz University.

Yael Langer has served as a member of the Board of Directors since July 2009. Ms. Langer has served as the general counsel and secretary of RAD Data Communications Ltd. and several other companies in the RAD-BYNET group since July 1998. Since December 2000, Ms. Langer has served as a director in Ceragon Networks Ltd., a company publicly-traded on NASDAQ and the Tel-Aviv stock markets. From December 1995 to July 1998, Ms. Langer served as assistant general counsel to companies in the RAD-BYNET group. From September 1993 until July 1995, Ms. Langer was a member of the legal department of Poalim Capital Markets and Investments Ltd., the underwriting and investment banking subsidiary of Bank Hapoalim. Prior to that, Ms. Langer was an attorney in the firm of Shimron, Molcho, Persky in Jerusalem. Ms. Langer holds an L.L.B. degree from The Hebrew University in Jerusalem, Israel.

Avraham Asheri has served as a member of the Board of Directors since July 2009. Mr. Asheri currently serves on the board of directors and several committees of the following companies: Elron Electronic Industries Ltd., Elbit Systems Ltd., Koor Industries Ltd., Discount Mortgage Bank Ltd. and Micronet Ltd. Mr. Asheri was the President and Chief Executive Officer of Israel Discount Bank (“DB”) during the years 1991 to 1998. Prior to that, from 1983 until 1991 he served as Executive Vice President of DB and a member of its Management Committee. Before that, Mr. Asheri served at the Israel Ministry of Industry and Trade and at the Israel Ministry of Finance, including in the positions of Director General of the Ministry of Industry and Trade, Managing Director of Israel Investment Center, and Trade Commissioner of Israel to the United States. Mr. Asheri acts as chairman of the Audit Committee of the Board of Governors of the Hebrew University, member of the Executive Committee of the Jerusalem Institute for Israel Studies, member of the Executive Committee of Hadassah Academic College and Chairman of its Finance Committee, and member of the Audit Committee of the Jerusalem Foundation and Board member and Chairman of Finance Committee of Mishkenot Sha’ananim. Mr. Asheri holds a BA degree in economics and political science from The Hebrew University in Jerusalem, Israel.

#### Additional Information

Under NASDAQ requirements, a majority of the members of our Board of Directors are required to be “independent” as defined under NASDAQ Marketplace Rules. We currently satisfy this requirement because four of our seven directors (Mr. David Rubner, Prof. Yair Tauman, Mr. Avraham Asheri and Dr. Hagen Hultzsich) qualify as “independent directors” under the NASDAQ Marketplace Rules.

Yehuda Zisapel, the Chairman of the Board of Directors, co-founder of the Company, and its largest shareholder, is the father of Roy Zisapel, a director and the Company’s President and Chief Executive Officer. In accordance with the Companies Law, Mr. Zisapel’s service as our Chairman was approved by our shareholders in September 2011. There are no other family relationships between any of the directors or members of senior management named above.

#### B. Compensation

##### General

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

|  | Salaries, fees, commissions and bonuses | Pension, retirement and other similar benefits |
|--|---|--|
| 2011 - All directors and officers as a group, consisting of 13 persons | \$ 1,945,000                            | \$274,000                                      |
| 2012 - All directors and officers as a group, consisting of 11 persons | \$ 1,729,000                            | \$219,000                                      |

An external director is entitled to consideration and reimbursement of expenses only as provided in regulations promulgated under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with his service as an external director. Our non-employee directors, including external directors, are entitled to the following compensation: (i) annual compensation in the amount of NIS 120,800 (currently equivalent to approximately \$32,500) per year of service; (ii) per meeting remuneration of NIS 3,600 (currently equivalent to approximately \$1,000) for each board or committee meeting attended, provided that the director is a member of such committee; (iii) compensation for telephonic participation in board and committee

meetings in an amount of 60% of what is received for physical participation; and (iv) compensation for board and committee meetings held via electronic means without physical participation in an amount of 50% of what is received for physical meeting. All amounts payable under items (i), (ii), (iii) and (iv) are subject to adjustment for changes in the Israeli consumer price index after December 2007 and changes in the amounts payable pursuant to Israeli law from time-to-time.

In addition, our non-employee directors, including external directors, are entitled to a grant of options under our stock option plans to purchase 10,000 ordinary shares for each year in which such non-employee director holds office. The options will be granted for three years in advance, and every director receives an initial grant of options to purchase 30,000 ordinary shares which vest over a period of three years, with a third (10,000) to vest upon each anniversary of service, provided that the director still serves on the Company's Board of Directors on the date of vesting. The grant will be made on the date of the director's election (or the date of commencement of office, if different), and thereafter, every three years, if reelected, an additional grant of options to purchase an additional 30,000 ordinary shares will be made on the date of each annual meeting in which such director is reelected. The exercise price of all options shall be equal to the fair market value of the ordinary shares on the date of the grant (i.e., an exercise price equal to the market price of our ordinary shares on the date of the annual meeting approving the election or reelection of a director or the date of commencement of office, if different).

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

During 2012, we granted to our directors and officers listed in Item 6A above options to purchase, in the aggregate, 115,000 ordinary shares at a weighted average exercise price per share of \$32.65. The options expire sixty-two months after grant.

#### Chief Executive Officer Compensation

On December 31, 2007, our shareholders approved the increase of our Chief Executive Officer's compensation, entitling him to a base salary in NIS equivalent to \$250,000 per annum. Pursuant to our shareholders' approval on October 5, 2010, effective as of 2010, our Chief Executive Officer is entitled to an annual bonus structure which is comprised of two components, where (i) reaching 100% achievement of the milestones will entitle our Chief Executive Officer to a bonus of \$175,000 and (ii) outperformance (achievements exceeding 100% of the milestones) or other extraordinary targets set by the Compensation Committee (as approved by the Audit Committee and the Board of Directors) will entitle our Chief Executive Officer to an additional bonus of up to \$75,000. Based on the 2012 milestones, our Chief Executive Officer was granted a bonus of \$130,000 for 2012. Based on the 2011 milestones, our Chief Executive Officer was granted a bonus of \$122,500 for 2011.

On November 8, 2012, our shareholders approved the increase of our Chief Executive Officer's compensation as of January 1, 2013, entitling him to a base salary of \$300,000 per annum and an increase of the annual bonus to \$300,000, where: (i) reaching 100% achievement of the milestones will entitle our Chief Executive Officer to a bonus of \$210,000 and (ii) outperformance (achievements exceeding 100% of the milestones) or other extraordinary targets set by the Compensation Committee (as approved by the Audit Committee and the Board of Directors) will entitle our Chief Executive Officer to an additional bonus of up to \$90,000. In addition, our shareholders approved an additional temporary quarterly payment of \$25,000, effective as of the January 1, 2012 as compensation for our Chief Executive Officer's additional duties and tasks in the United States. In this position, Mr. Zisapel manages our entire on-going North Americas activities, including sales, administration and operations. The additional amount will be payable for as long as Mr. Zisapel maintains this additional position.

On December 31, 2007, following the approval of our shareholders, we granted 500,000 stock options to our Chief Executive Officer with an exercise price of \$15.22 per share, which expire on December 31, 2014. The vesting of these options was contingent upon the increase in the market price of our ordinary shares compared to the closing share price on NASDAQ immediately prior to the time that the shareholder meeting was convened. All of these options have fully vested.



On July 19, 2009, following the approval of our shareholders, we granted 400,000 stock options to our Chief Executive Officer to purchase ordinary shares with an exercise price of \$8.78 per share. Half (50%) of these options became exercisable two years following the grant, 25% of those options became exercisable three years following the grant and the remainder are exercisable four years following the grant. The options expire 62 months from the grant date, i.e., on September 18, 2014.

## C.

## Board Practices

## Introduction

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

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

Our Articles of Association provide for a Board of Directors of not less than five and not more than nine directors. Currently, our Board of Directors consists of seven directors, including the external directors (as described below). In accordance with current NASDAQ requirements, nominees for election as directors are approved and recommended to the Board of Directors by a decision of a majority of our independent directors.

Under the Companies Law, our Board of Directors is required to determine the minimum number of directors having accounting and financial expertise, as defined in regulations promulgated under the Companies Law, that our Board of Directors should have. In determining the number of directors required to have such expertise, the Board of Directors must consider, among other things, the type and size of the company and the scope and complexity of its operations. Our Board of Directors has determined that we require at least one director with the requisite financial and accounting expertise and that Mr. Avraham Asheri has such expertise.

## Staggered Board

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

| Class     | Term expiring at<br>the annual meeting<br>for the year | Directors                            |
|-----------|--|--------------------------------------|
| Class I   | 2015   | Yehuda Zisapel and<br>Avraham Asheri |
| Class II  | 2013   | Roy Zisapel                          |
| Class III | 2014   | Hagen Hultzsich and Yael<br>Langer   |

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

The above classification does not apply to Mr. David Rubner and Prof. Yair Tauman, who were appointed as external directors and whose term of appointment ends in 2015 and 2013, respectively.

For a description of how long our directors and officers have served in their current positions, please see “Item 6A - Directors, Senior Management and Employees – Directors and Senior Management”.

## External Directors

### Qualifications of External Directors

Under the Companies Law, companies incorporated under the laws of Israel whose shares are listed for trading on a stock exchange or have been offered to the public in or outside of Israel, such as Radware, are required to appoint at least two external directors. External directors are required to possess professional qualifications as set out in regulations promulgated under the Companies Law. To qualify as an external director, an individual (or the individual's relative, partner, employer or any entity under the individual's control) may not have, and may not have had at any time during the previous two years, any "affiliation" with:

- the company, the company's controlling shareholder or its relative, or another entity affiliated with the company or its controlling shareholder, or
- a company without a controlling shareholder (or a shareholder that owns more than 25% of its voting power), such as Radware, any person who, at the time of appointment, is the chairman, the chief executive officer, the chief financial officer or a 5% shareholder of the company.

The term affiliation includes:

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

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

No person can serve as an external director if the person's position or other business creates, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director.

Until the lapse of two years from termination of office as an external director, a company and its controlling shareholder may not provide compensation to an external director or his or her spouse and children or engage such persons to serve as an office holder and cannot employ or receive services from such persons, either directly or indirectly, including through a corporation controlled by that person. The same restriction applies to other family members of the external director but until the lapse of one year from termination of office as an external director.

### Election of External Directors

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

- at least a majority of the shares of non-controlling shareholders voted at the meeting in favor of the election; or

- the total number of shares voted against the election of the external director does not exceed 2% of the aggregate voting rights in the Company.

The initial term of an external director is three years and may be extended for up to two additional three-year terms. Thereafter, in a company whose shares are listed for trading on, among others, the Nasdaq Global Select Market, such as Radware, he or she may be reelected by our shareholders for additional periods of up to three years each only if the Audit Committee and Board of Directors confirm that, in light of the external director's expertise and special contribution to the work of the Board of Directors and its committees, the reelection for such additional period is beneficial to the Company. Reelection of an external director may be effected through one of the following mechanisms: (1) the board of directors proposed the reelection of the nominee and the election was approved by the shareholders by the majority required to appoint external directors for their initial term as described above; or (2) a shareholder holding 1% or more of the voting rights proposed the reelection of the nominee, and the reelection is approved by a majority of the votes cast by the shareholders of the company, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders; provided that the aggregate votes cast in favor of the reelection by such non-excluded shareholders constitute more than 2% of the voting rights in the company.

External directors may be removed from office only by the vote of the same percentage of shareholders as is required for their election or by a court but only if they cease to meet the statutory qualifications for appointment or if they violate their duty of loyalty to the Company.

Each committee of the Company's board of directors is required to include at least one external director, except for the Audit and Compensation Committees which are required to be comprised of all the external directors.

Currently, Mr. David Rubner and Prof. Yair Tauman qualify as external directors under the Companies Law and were elected by the general shareholders meetings held in November 2012 and October 2010, respectively, to serve as our external directors for three-year terms ending in 2015 and 2013, respectively.

Under the Companies Law and regulations promulgated thereunder, (1) an external director must have either "accounting and financial expertise" or "professional qualifications" (as such terms are defined in regulations promulgated under the Companies Law) and (2) at least one of the external directors must have "accounting and financial expertise." However, companies whose shares are registered for trade outside of Israel, such as us, are in compliance with such requirements if all of their external directors have "professional qualifications" and one of their other independent directors has "accounting and financial expertise". Our Board of Directors has determined that Mr. Avraham Asheri, one of our other independent directors, has "accounting and financial expertise" and that Mr. David Rubner and Prof. Yair Tauman, our external directors, have "professional qualifications", and, therefore, we believe we satisfy these requirements.

#### Our Committees

The Board of Directors appoints committees to help carry out its duties. Each committee reports the results of its meetings to the full Board of Directors. The Board of Directors established its Audit Committee and Compensation Committee in 1999. Only non-employee directors serve on our Audit Committee and Compensation Committee.

#### Audit Committee

#### NASDAQ Requirements

Our ordinary shares are listed on the NASDAQ Global Select Market, and we are subject to the rules of the NASDAQ applicable to listed companies. Under the NASDAQ rules, we are required to have an audit committee consisting of at least three independent directors, all of whom are financially literate and one of whom has accounting or related financial management expertise.

Our Board has determined that all directors serving on our Audit Committee (Mr. Avraham Asheri, Mr. David Rubner, Dr. Hagen Hultsch and Prof. Yair Tauman) meet the independence standards required of Audit Committee members by the Securities Exchange Act of 1934 and the NASDAQ Marketplace Rules. In addition, the Board of Directors has determined that Mr. Avraham Asheri is considered an "audit committee financial expert" (as defined by SEC rules).

In accordance with the NASDAQ Marketplace Rules, the Audit Committee has adopted a charter that sets forth the Audit Committee's purpose and responsibilities, which include, among other things, (1) assisting the Board of Directors in fulfilling its responsibility for oversight of the quality and integrity of our accounting, auditing and financial reporting practices and financial statements and the independence qualifications and performance of our independent auditors, and (2) selecting, evaluating and, where appropriate, recommending to replace the independent auditors (or to nominate the independent auditors subject to shareholder approval) and to pre-approve audit engagement fees and all permitted non-audit services and fees. The Audit Committee must also review and approve

all related party transactions specified under Item 7B of Form 20-F.

The Audit Committee also functions as our Qualified Legal Compliance Committee, or the QLCC. In its capacity as the QLCC, the Audit Committee is responsible for investigating reports made by attorneys appearing and practicing before the SEC in representing us of perceived material violations of U.S. federal or state securities laws, breaches of fiduciary duty or similar violations by us or any of our agents.

## Israeli Companies Law Requirements

Under the Companies Law, our Audit Committee must be comprised of at least three directors, include all of the external directors, a majority of its members must satisfy the independence standards under the Companies Law, and the chairman thereof is required to be an external director.

In accordance with the Companies Law, the duties of our Audit Committee, in addition to the requirements imposed by the NASDAQ rules, include, among other things, to (1) identify irregularities in the business management of the Company, including in consultation with the internal auditor and/or the Company's independent accountants, and to recommend remedial measures to the Board of Directors, (2) review, and, where appropriate, approve certain interested party transactions specified under the Companies Law, as more fully described below under the heading "Approval of Specified Related Party Transactions under Israeli Law", and (3) examine and monitor the work of our internal auditor.

## Compensation Committee

Pursuant to applicable NASDAQ rules, the compensation payable to a company's chief executive officer and other executive officers must generally be approved by either a compensation committee comprised solely of independent directors or a majority of the independent directors. Under new NASDAQ rules effective July 1, 2013, compensation committees are to be granted additional authority and responsibilities with respect to the hiring of compensation advisors and other advisors. Under a recent amendment to the Companies Law, our Board of Directors is required to appoint a compensation committee comprised of at least three directors and which shall include all of the company's external directors. The other members of the compensation committee must satisfy certain independence standards under the Companies Law, and the chairman is required to be an external director. Under the Companies Law, the role of the compensation committee includes recommending to the Board of Directors, for ultimate shareholder approval by a special majority, a policy governing the compensation of office holders based on specified criteria; reviewing, from time to time, modifications to the compensation policy and examining its implementation; approving the actual compensation terms of office holders prior to approval thereof by the Board of Directors; and resolving whether to exempt the compensation terms of a candidate for chief executive officer from shareholder approval.

Our Compensation Committee was created in 1999 as the Share Incentive Committee and was renamed the Compensation Committee in 2004. Pursuant to its charter, the Compensation Committee is authorized to make decisions regarding executive compensation and terms and conditions of employment, to follow market trends and provide recommendations to the Board of Directors in connection with the Company's general compensation philosophy and policies, as well as to recommend that the Board of Directors issue options under our stock option plans. The Compensation Committee reviews and determines, on behalf of the Board of Directors, the amounts and types of compensation to be paid to the Company's Chief Executive Officer and other executive officers.

The Compensation Committee currently consists of Mr. David Rubner and Prof. Yair Tauman, who are also our external directors, and Dr. Hagen Hultzs, all of whom are independent directors.

## Nomination of Directors

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

## Board and Committee Meetings

| Name of Body | No. of Meetings in 2012 | Average Attendance |
|--------------|-------------------------|--------------------|
|--------------|-------------------------|--------------------|



|                        |   | Rate |   |
|------------------------|---|------|---|
| Board of directors     | 9 | 97   | % |
| Audit committee        | 6 | 90   | % |
| Compensation committee | 4 | 90   | % |

Each director attended at least 89% of all Board meetings.

## Directors' Service Contracts

Except as described in Item 6B above, we do not, as of the date of filing of this Annual Report, have service or employment contracts with our directors providing for benefits upon termination of employment.

## Internal Auditor

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

## Approval of Specified Related Party Transactions under Israeli Law

### Fiduciary Duties of Office Holders

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

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

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

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

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

### Disclosure of Personal Interest of an Office Holder

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

meeting in which the transaction is first discussed. If the transaction is an extraordinary transaction, the office holder's duty to disclose also applies to a personal interest of a relative of the office holder.

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

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

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

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

#### Approval of Office Holder Compensation

A recent amendment to the Companies Law imposes new approval requirements for the compensation of office holders. Every Israeli public company, such as Radware, must adopt a compensation policy, recommended by the compensation committee, and approved by the board of directors and the shareholders, in that order, no later than September 2013. The shareholder approval requires a majority of the votes cast by shareholders, excluding any controlling shareholder and those who have a personal interest in the matter. In general, all office holders' terms of compensation – including fixed remuneration, bonuses, equity compensation, retirement or termination payments, indemnification, liability insurance and the grant of an exemption from liability – must comply with the company's compensation policy. In addition, the compensation terms of directors, the chief executive officer, and any employee or service provider who is considered a controlling shareholder must be approved separately by the compensation committee, the board of directors and the shareholders of the company (by the same majority noted above), in that order. The compensation terms of other officers require the approval of the compensation committee and the board of directors.

#### Disclosure of Personal Interests of a Controlling Shareholder

Under the Companies Law, the disclosure requirements which apply to an office holder also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder that owns 25% or more of the voting power in the company, if no other shareholder owns more than 50% of the voting power in the company, but excluding a shareholder whose power derives solely from his or her position on the board of directors or any other position with the company.

Extraordinary transactions of a public company with a controlling shareholder or with a third party in which a controlling shareholder has a personal interest, and the terms of engagement of a controlling shareholder as an office holder or employee, generally require the approval of the audit committee, the board of directors and the shareholders of the company in that order. The shareholder approval must be by a majority of the shares voted on the matter, provided that either:

- At least a majority of the shares of shareholders who have no personal interest in the transaction, and who are present and voting (in person, by proxy or by written ballot) vote in favor thereof; or
- The shareholders who have no personal interest in the transaction who vote against the transaction do not represent more than 2% of the voting power in the company.

In addition, any such extraordinary transaction whose term is longer than three years may require further shareholder approval every three years, unless, where permissible under the Companies Law, the audit committee approves that a longer term is reasonable under the circumstances.

#### General Duties of Shareholders

Under the Companies Law, each shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations toward the company and other shareholders and to refrain from abusing his power in the company, such as shareholder votes. Furthermore, specified shareholders have a duty of fairness toward the company. These shareholders include any controlling shareholder, any shareholder who knows that he/it possesses the power to determine the outcome of a shareholder vote, and any shareholder who, pursuant to the provisions of the articles of association, has the power to appoint or to prevent the appointment of an office holder or any other power toward the company.

D. Employees

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

The following table details certain data on our workforce (including temporary employees and subcontractors) as at the period indicated:

|   | 2012 | As at December 31, |     |      |     |     |
|---|------|--------------------|-----|------|-----|-----|
|   |      | 2011               |     | 2010 |     |     |
| Approximate numbers of employees and subcontractors by geographic location  |      |                    |     |      |     |     |
| Israel  | 366  | 327                |     | 304  |     |     |
| United States   | 130  | 120                |     | 116  |     |     |
| Other   | 304  | (*) 286            | (*) | 299  | (*) | (*) |
| Total workforce   | 800  | 733                |     | 719  |     |     |
| Approximate numbers of employees and subcontractors by category of activity |      |                    |     |      |     |     |
| Research and development  | 328  | (*) 306            | (*) | 315  | (*) | (*) |
| Sales, technical support, business development and marketing                | 375  | 340                |     | 323  |     |     |
| Management, operations and administration                                   | 97   | 87                 |     | 81   |     |     |
| Total workforce   | 800  | 733                |     | 719  |     |     |

(\*) Include 77, 98 and 108 subcontractors, as of December 31, 2012, 2011 and 2010, respectively.

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

Furthermore, our Israeli employees and we are subject to provisions of the collective bargaining agreements between the “Histadrut”, the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialists Association, by governmental order. These provisions principally concern social benefits, cost of living increases, recreation pay and other conditions of employment. We generally provide our employees with benefits and working conditions above the required minimums.

Our employees are not represented by a labor union. The employees of our subsidiaries are subject to local labor laws, regulations and/or collective bargaining agreements that vary from country to country.

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

#### E. Share Ownership

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares by our directors and officers as of March 10, 2013. The percentage of outstanding ordinary shares is based on 22,414,709 ordinary shares outstanding as of March 10, 2013.

| Name   | Number of ordinary shares | Percentage of outstanding ordinary shares |   |
|--|---------------------------|---|---|
| Yehuda and Nava Zisapel (1)                                      | 2,715,938                 | 12.11                                     | % |
| Roy Zisapel (2)  | 1,318,225                 | 5.68                                      | % |
| Meir Moshe (3)   | *                         | *   |   |
| Avraham Asheri (3)   | *                         | *   |   |
| Hagen Hultzs (3)   | *                         | *   |   |
| Yael Langer (3)  | *                         | *   |   |
| David Rubner (3)   | *                         | *   |   |
| Yair Tauman (3)  | *                         | *   |   |
| Ilan Kinreich (3)  | *                         | *   |   |
| Avi Chesla (3)   | *                         | *   |   |
| Sharon Trachtman (3)   | *                         | *   |   |
| All directors and executive officers as a group (11 persons) (4) | 4,247,959                 | 18.24                                     | % |

(1) Of the ordinary shares beneficially owned by Mr. Yehuda Zisapel and his wife Nava Zisapel, (i) 1,152,889 are held directly by Yehuda Zisapel and 1,252,621 are held directly by Nava Zisapel; (ii) 3,801 options to purchase ordinary shares are fully vested or will be fully vested with Yehuda Zisapel within the next 60 days, at an exercise price of \$8.78 per share, expiring in September, 2014; (iii) 261,233 are held of record by Carm-AD Ltd., an Israeli company wholly-owned in equal shares by Yehuda Zisapel and his wife Nava Zisapel; and (iv) 45,394 are held of record by Radbit Computers Inc. which is indirectly held in equal shares by Yehuda Zisapel and his wife, Nava Zisapel. Yehuda and Nava Zisapel have an agreement which provides for certain coordination in respect of sales of shares of Radware as well as for tag along rights with respect to off-market sales of shares of Radware.

(2) Consists of 518,225 shares and 800,000 options to purchase ordinary shares, which are fully vested or which will be fully vested within the next 60 days. The options consist of 300,000 options at an exercise price of \$8.78 per share which expire in September, 2014 and 500,000 options at an exercise price of \$15.22 per share which expire in December, 2014.

(3) Owns less than 1% of our outstanding ordinary shares (including options held by each such party, which are vested or shall become vested within 60 days of the date of this annual report) and have therefore not been separately disclosed.

(4) Consists of 3,376,658 shares and 871,301 options to purchase ordinary shares which are fully vested or which will be fully vested within the next 60 days. The options consist of 333,801 options at an exercise price of \$8.78 which expire in September, 2014, 500,000 options at an exercise price of \$15.22 which expire in December, 2014, 20,000 options at an exercise price of \$34.58 which expire in December, 2015, 7,500 option at an exercise price of \$35.93 which expire in December 2015 and 10,000 options at an exercise price of \$24.67 which expire in November 2016.

#### Key Employee Share Incentive Plan

In August 1997, we adopted our Key Employee Share Incentive Plan (1997), as amended, or the Share Incentive Plan. Under the plan stock options as well as restricted stock units may be granted to employees employed by us or by our affiliates.

The Share Incentive Plan is administered by the Compensation Committee subject to the provisions of the Companies Law. Pursuant to the plan, the Compensation Committee has the authority to determine (subject to applicable law), or

advise the Board of Directors, in its discretion:

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



In addition, the Share Incentive Plan provides that, unless otherwise determined otherwise by our Board of Directors (or a committee thereof), in the event of a “Hostile Takeover”, which is defined to include, among others, an unsolicited acquisition of more than 20% of our outstanding shares (other than a purchase by Mr. Yehuda Zisapel), the vesting of all or a portion of our outstanding equity awards, including stock options, will accelerate. As a result, an acquisition of our Company that triggers the said acceleration will be more costly to a potential acquirer.

Options granted pursuant to the Share Incentive Plan are typically granted for a term of sixty-two months from the date of the grant of the option. As of December 31, 2012, 11,187,318 ordinary shares have been reserved for equity grants under the plan, of which we have granted options to purchase 10,741,601 ordinary shares at a weighted average exercise price of \$12.77 per ordinary share. To date, no restricted stock units have been granted.

The Share Incentive Plan allows the allocation of short term options to grantees who are not residents of Israel or the United States, with a grant price of 90% of the closing sales price for the shares on the NASDAQ on the date of grant of a respective option award. As of December 31, 2012, 500,000 ordinary shares have been reserved for option grants under this arrangement, of which we have granted options to purchase 118,347 ordinary shares at a weighted average exercise price of \$14.18 per ordinary share. This arrangement does not affect the possibility of issuing options under the Share Incentive Plan as detailed above. However, any person who participates in the ESPP (as defined below) shall not be an eligible grantee for purposes of such arrangement.

#### Directors and Consultants Option Plan

In February 2000, we adopted a Directors and Consultants Option Plan, which is administered by our Compensation Committee. Options granted pursuant to our Directors and Consultants Options Plan are for a term of sixty-two months from the date of the grant of the option. The terms of the Directors and Consultants Option Plan are similar to the terms of the Share Incentive Plan. The Directors and Consultants Option Plan relies on the 11,187,318 ordinary shares reserved for option grants shares under the Share Incentive Plan which can be rolled over between such plans. The Compensation Committee may not grant options to members of the Committee or to a shareholder of over 10% of our issued and outstanding shares.

#### Employee Share Purchase Plan

In February 2010, our Board of Directors adopted the 2010 Employee Share Purchase Plan (“ESPP”), which provides for the issuance of a maximum of 1,000,000 ordinary shares. Pursuant to the ESPP, eligible employees (including only Israeli and United States residents) could have up to 10% of their net income withheld, up to certain maximums, to be used to purchase our ordinary shares. The ESPP is implemented with overlapping one year offering periods, each one consisting of two purchases, once in every six-month period. The price of each ordinary share purchased under the ESPP is equal to 90% of the closing price for the shares on the respective offering date. As of December 31, 2012, 127,780 shares have been purchased under the ESPP of which 59,451, 68,329, and 0 shares were purchased during 2010, 2011 and 2012, respectively.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

## A. Major Shareholders

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of March 10, 2013, by each person or entity known to own beneficially more than 5% of our outstanding ordinary shares based on information provided to us by the holders or disclosed in public filings with the SEC. The voting rights of all major shareholders are the same as for all other shareholders.

| Name                               | Number of<br>ordinary<br>shares | Percentage<br>of<br>outstanding<br>ordinary<br>shares |   |
|------------------------------------|---------------------------------|---|---|
| Cadian Capital Management, LLC (1) | 1,815,522                       | 8.10  | % |
| Nava Zisapel (2)                   | 1,559,248                       | 6.96  | % |
| Rima Management, LLC (3)           | 1,540,445                       | 6.87  | % |
| Yehuda Zisapel (4)                 | 1,463,317                       | 6.53  | % |
| Federated Investors, Inc. (5)      | 1,299,400                       | 5.80  | % |
| Roy Zisapel (6)                    | 1,318,225                       | 5.68  | % |

(1) This information is based on information provided in the Amendment No. 2 to Statement on Schedule 13G filed with the SEC by Cadian Capital Management, LLC and Mr. Eric Bannasch on February 14, 2013. Based on the Schedule 13G previously filed with the SEC by Cadian and Mr. Bannasch they beneficially owned, as of February 14, 2012 5.09% of our outstanding ordinary shares, as of March 18, 2011, 5.22% of our outstanding ordinary shares.

(2) Of the ordinary shares beneficially owned by Ms. Nava Zisapel, (i) 1,252,621 are held directly; (ii) 261,233 are held of record by Carm-AD Ltd., an Israeli company owned 50% by Nava Zisapel; and (iii) 45,394 are held of record by Radbit Computers Inc. which is indirectly held 50% by Nava Zisapel. As noted in note 1 in “Item 6E – Share Ownership,” Yehuda and Nava Zisapel have an agreement which provides for certain coordination in respect of sales of shares of Radware as well as for tag along rights with respect to off-market sales of shares of Radware.

Shares are beneficially owned by Rima Senvest Management, LLC, a Delaware corporation (“Rima”), and Richard Mashaal, a Canadian citizen. This information is based on information provided in the Amendment No. 6 to Statement on Schedule 13G filed with the SEC by Mr. Mashall and Rima on February 14, 2013. Based on previous amendments to the Schedule 13G filed with the SEC by Mr. Mashall and Rima, Rima beneficially owned, as of February 14, 2012, 7.81% of our outstanding ordinary shares, as of March 18, 2011, 7.35% of our outstanding ordinary shares and as of April 10, 2010, 9.77% of our outstanding ordinary shares.

(4) Of the ordinary shares beneficially owned by Mr. Yehuda Zisapel, (i) 1,152,889 are held directly; (ii) 3,801 options to purchase ordinary shares are fully vested or will be fully vested with Yehuda Zisapel within the next 60 days, at an exercise price of \$8.78 per share, expiring in September, 2014; (iii) 261,233 are held of record by Carm-AD Ltd., an Israeli company owned 50% by Yehuda Zisapel; and (iv) 45,394 are held of record by Radbit Computers Inc. which is indirectly held 50% by Yehuda Zisapel. As of March 25, 2012 Mr. Zisapel owned 13.26%, as of March 18, 2011 Mr. Zisapel owned 14.13% and as of April 10, 2010 Mr. Zisapel owned 16.91% of our outstanding shares. As noted in note 1 in “Item 6E – Share Ownership,” Yehuda and Nava Zisapel have an agreement which provides for certain coordination in respect of sales of shares of Radware as well as for tag along rights with respect to off-market sales of shares of Radware.

(5) Shares are beneficially owned by Federated Investors, Inc. (the “Parent”) the parent holding company of Federated Equity Management Company of Pennsylvania and Federated Global Investment Management Corp. (the “Investment Advisers”), which act as investment advisers to registered investment companies and separate accounts that own our shares of common stock. The Investment Advisers are wholly owned subsidiaries of FII Holdings, Inc., which is wholly owned subsidiary of Federated Investors, Inc., the Parent. All of the Parent’s outstanding voting stock is held in the Voting Shares Irrevocable Trust (the “Trust”) for which John F. Donahue, Rhodora J. Donahue and J. Christopher Donahue act as trustees (collectively, the “Trustees”). This information is based on information provided in the Amendment No. 5 to Statement on Schedule 13G filed with the SEC by Parent, the Trust and the Trustees on February 12, 2013. Based on previous amendments to the Schedule 13G filed with the SEC by Federated Investors, Inc., it beneficially owned, as of February 9, 2012 6.40% of our outstanding ordinary shares, as of March 18, 2011, 7.48% of our outstanding ordinary shares and as of April 10, 2010, 10.05% of our outstanding ordinary shares.

(6) Includes: (i) 518,225 ordinary shares held directly; and (ii) 800,000 options to purchase ordinary shares, which are fully vested or which will be fully vested within the next 60 days. The options consist of 300,000 options at an exercise price of \$8.78 per share which expire in September, 2014 and 500,000 options at an exercise price of \$15.22 per share which expire in December 2014.

#### Major Shareholders Voting Rights

Our major shareholders do not have different voting rights from those of other shareholders.

#### Record Holders

Based on a review of the information provided to us by our transfer agent, as of March 11, 2013, there were 32 holders of record of our ordinary shares, of which 17 record holders, holding approximately 11.66% of our ordinary shares, had registered addresses in Israel, and of which 13 record holders, holding approximately 88.34% of our ordinary shares, had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our ordinary shares nor is it representative of where such beneficial holders reside, since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 87.93% of our outstanding ordinary shares as of said date).

#### B. Related Party Transactions

##### General

We have entered into a number of agreements with certain companies, of which Yehuda and Zohar Zisapel are co-founders, directors and/or principal stockholders, collectively known as the RAD-Bynet Group. See Item 4C – Organizational Structure.” Of these agreements, the lease for our headquarters in Tel Aviv is material to our operations. We believe that the terms of the transactions to which we have entered with members of the RAD-Bynet Group are not different in any material respect from terms we could obtain from unaffiliated third parties. The pricing of the transactions was based on negotiations between the parties. Members of our management reviewed the pricing of the lease agreement, as well as, in some cases, used a third-party consulting firm, and confirmed that it was not different in any material respect than that which could have been obtained from unaffiliated third parties.

In addition, the Company purchases different services from third parties at special rates offered to the RAD-Bynet Group, such as car leases, maintenance, insurance and communication services. In the event that we cease to be a member of the RAD-Bynet Group, we may not be able to obtain the current rates for such services. We believe, however, that due to the affiliation between us and the RAD-Bynet Group, we have greater flexibility in obtaining certain terms and conditions that may not be available from unaffiliated third parties on similar products and services.

The RAD-Bynet Group consists of high-tech manufacturers of hardware and software products and data communication providers, distributors and integrators as well as service providers. The RAD-Bynet Group includes approximately 15 different companies dealing in advanced communication technology, networks, and integration. Companies within the RAD-Bynet Group provide a variety of services to their customers, including: engineering, purchasing and sub-contracting, production and final testing, planning and control, and support for end users. The RAD-Bynet Group also includes a few companies which provide services in order to support the activities of the other RAD-Bynet Group members, such as real estate leasing and administrative services. Each company in the RAD-Bynet Group is independent from the others. The ownership and Board of Directors structure of each RAD-Bynet Group member is different and certain of the RAD-Bynet Group members are publicly traded companies.

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

### Lease of Property

We lease the office space for our headquarters and principal R&D, administrative, finance and marketing and sales operations from private companies within the RAD-Bynet Group that are owned by Messrs. Zohar Zisapel and Yehuda Zisapel:

- One lease (the "Headquarters Lease") is a five-story building in Tel Aviv, Israel, consisting of approximately 36,000 square feet, plus storage and parking space. The lease expires in November 2017. The annual rent amounts to approximately \$748,000.
- The second lease consists of two floors in the Or Tower in Tel Aviv, Israel with approximately 30,000 square feet, plus parking spaces. The lease expires in May 2014. The annual rent for such two floors amounts to approximately \$664,000.
- The third lease consists of one floor in the second wing of Or Tower in Tel Aviv, Israel, with approximately 12,000 square feet, plus parking spaces. The lease expires in May 2014. The annual rent amounts to approximately \$200,000.

In addition, we lease approximately 6,300 square feet of space in Jerusalem, Israel, for development facilities from an affiliated company owned by Messrs. Yehuda and Zohar Zisapel. This lease expires in February 2014. The annual rent amounts to approximately \$98,400.

We entered into an agreement with RAD Data Communications, Inc., a company controlled by Yehuda and Zohar Zisapel, pursuant to which we lease approximately 14,800 square feet in Mahwah, New Jersey, consisting of approximately 10,600 square feet of office space and 4,300 square feet of warehouse space, in consideration for annual rent of approximately \$234,000 (including taxes, electricity and management fees). The lease expires on April 20, 2014. We have exercised an option to extend such lease for an additional period of one year. During the extended period, the annual rent amounts to approximately \$234,000.

### Distribution Agreement

Bynet Data Communications Ltd., a member of the RAD-Bynet Group, distributes our products in Israel on a non-exclusive basis. We have a written distributor agreement with Bynet Data Communications Ltd. under which we provide Bynet Data Communications with discounts similar to the discounts provided to third-party distributors in the region in the ordinary course of business. The total sales to Bynet Data Communications (and other companies in the RAD-Bynet Group) amounted to approximately \$4.2 million in 2012, compared to \$6.2 million in 2011.

### Additional RAD-Bynet Group Services

The Company receives the following additional services from members of the RAD-Bynet Group: network management; information technology and communication services; equipment testing and repair; electricity charges; parking and building maintenance; reception services; vehicles and human resource administration; distribution services; and marketing services. Each of these additional services is not material, individually or in the aggregate, to the Company or the RAD-Bynet Group.

A portion of the above services, such as electricity charges, are "pass through" services for which we are charged on a "back-to-back" basis according to our actual usage (i.e., we are charged pro ratably based on the actual charge of the third party electricity company) due to the fact that we lease part of our facilities from a number of other RAD-Bynet Group members. Other services mentioned above, such as vehicles and human resource administration, are performed

by one of the RAD-Bynet Group companies and are provided to all members of the RAD-Bynet Group, in order to achieve lower prices for these services based on economies of scale. In addition, since the RAD-Bynet Group is comprised of a number of companies which are engaged in our industry, the RAD-Bynet Group initiates marketing events from time to time, which we participate in, to promote the RAD-Bynet Group members' products. The charges for these services are based on actual costs incurred and are allocated to the Company according to its relative part in such services (e.g., vehicles administration – according to the number of the Company's vehicles out of the total vehicles of the RAD-Bynet Group; marketing events – according to the number of participants of the Company's customers out of the total participants in the events).

All other services, such as communication and distribution services are provided to the Company on the same basis and terms as provided to unrelated companies outside the RAD-Bynet Group, and were compared to prices the Company could have obtained from unaffiliated third parties and were found to be equal or less expensive. All services are charged on a monthly basis and on terms which are generally typical for other third party providers of the Company.

#### Compensation of Chief Executive Officer

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

#### C. Interests of Experts and Counsel

Not applicable.

### ITEM 8. FINANCIAL INFORMATION

#### A. Consolidated Statements and other Financial Information

##### Financial Statements

See “Item 18 - Financial Statements”.

##### Export Sales

For the year ended December 31, 2012, the amount of our export sales (i.e., sales outside Israel) was approximately \$182 million, which represents 96% of our total sales.

##### Legal Proceedings

We are, or may be, from time to time named as a defendant in certain routine litigation incidental to our business. However, we are currently not, and have not been in the recent past, a party to any legal proceedings which may have or have had in the recent past significant effects on our financial position or profitability, other than as set forth below.

##### SNMP Intellectual Property Claim

In November 2011, SNMP Research International, Inc. and SNMP Research, Inc. commenced a lawsuit in the United States Bankruptcy Court for the District of Delaware against Nortel Networks, Inc. (and certain of its affiliates entities), Genband US LLC, GENBAND, Inc., Performance Technologies, Inc., Perftech (PTI) Canada, Avaya, Inc. and Radware, Ltd. The complaint alleges that we have infringed certain of SNMP’s copyrights, misappropriated certain of SNMP’s trade secrets, were unjustly enriched, and converted certain of SNMP’s intellectual property. SNMP has asserted that as part of our acquisition of the Layer 4-7 Application Delivery business from Nortel Networks in March 2009, we received certain intellectual property of SNMP Research that was embedded in the Layer 4-7 business. The complaint does not specify the amount of damages and requests that such amount be determined at trial. We were recently served with the complaint in Israel. We advised SNMP Research that we diligently investigated whether software received from Nortel included SNMP Software, and based on such investigation no SNMP Software was found. Draft settlement agreements are circulating which impose no liability on us. If settlement is not reached and SNMP Research does not dismiss the lawsuit, we intend to vigorously defend the litigation which still is in a preliminary stage, and we cannot estimate what impact, if any, the litigation may have on our results of operations, financial condition or cash flows.





#### BB&T Indemnification Claim

On October 22, 2012, Branch Banking and Trust Co. ("BB&T") filed a third-party complaint in the Eastern District of Texas against Radware Inc., our wholly owned subsidiary, seeking indemnification for patent infringement claims brought by TQP Development LLC ("TQP") against BB&T in the same court. The complaint alleges that BB&T purchased certain products from Nortel Networks Inc. ("Nortel") and Covelight Systems Inc. and that TQP has alleged that BB&T's use of these products infringes certain TQP patents. BB&T further alleges that Radware Inc. is the successor in interest to Nortel and Covelight and that Radware, Inc. has refused to defend and hold BB&T harmless against TQP's allegations in breach of BB&T's agreements and warranties with Nortel and Covelight. On January 14, 2013, Radware, Inc. filed an answer and counterclaim denying that Radware, Inc. has any indemnity obligations to BB&T and seeking declaratory judgment as to each of BB&T's asserted causes of action. The Court has yet to schedule a case management conference regarding BB&T's third party complaint. On March 22, 2013, BB&T agreed to dismiss the complaint voluntarily and enter into a tolling agreement with Radware, Inc. that would prevent either party from refiling the lawsuit until after the underlying TQP patent infringement claims against BB&T are resolved.

#### Israeli Tax Authority Assessment Proceedings

In December 2010, following an audit of our Israeli tax returns for the 2004 and 2005 fiscal years, the Israeli Tax Authority ("ITA") issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 16.1 million (approximately \$4.3 million) for 2004 and NIS 15.5 million (approximately \$4.2 million) for 2005, including interest as of the assessment date.

In addition, in January 2012, following an audit of our Israeli tax returns for the 2006 and 2008 fiscal years, the ITA issued orders challenging our positions on several matters and demanded the payment of additional taxes in the aggregate amount of NIS 25.2 million (approximately \$6.8 million) for 2006 and NIS 8.1 million (approximately \$2.2 million) for 2008, including interest as of the assessment date.

We have appealed the orders relating to the four years mentioned above with the Tel Aviv District court, and these appeals are currently pending.

There can be no assurance that the courts will accept our positions on matters raised, and in such an event, we may be required to pay all or a portion of the amounts of these orders. Such a payment could result in a material adverse effect on our financial condition and results of operations.

#### Dividend Distribution Policy

We have never paid and do not intend to pay cash dividends on our ordinary shares in the foreseeable future. While we may engage from time to time in "buy-back" programs of our shares, our policy is to retain earnings and other cash resources to continue the development and expansion of our business. Any future dividend policy will be determined by our Board of Directors and will be based upon conditions then existing, including our results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions. See also Item 10B "- Dividend and Liquidation Rights."

#### B. Significant Changes

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



## ITEM 9. THE OFFER AND LISTING

## A. Offer and Listing Details

Our ordinary shares have been listed for quotation on the NASDAQ Global Select Market since September 30, 1999 under the symbol “RDWR”. From May 12, 2004 to March 8, 2009, our ordinary shares were also listed on the Tel Aviv Stock Exchange, or TASE. We voluntarily delisted our ordinary shares from the TASE primarily due to low trading volume.

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

| Annual High and Low | NASDAQ Global Select Market |         | Tel Aviv Stock Exchange |           |
|---------------------|-----------------------------|---------|-------------------------|-----------|
|                     | High                        | Low     | High                    | Low       |
| 2008                | \$14.84                     | \$4.99  | NIS 59.40               | NIS 18.11 |
| 2009                | \$15.12                     | \$5.15  | N/A                     | N/A       |
| 2010                | \$39.77                     | \$14.92 | N/A                     | N/A       |
| 2011                |                             |         |                         |           |
| First Quarter       | \$42.73                     | \$34.28 | N/A                     | N/A       |
| Second Quarter      | \$36.82                     | \$31.40 | N/A                     | N/A       |
| Third Quarter       | \$36.11                     | \$21.59 | N/A                     | N/A       |
| Fourth Quarter      | \$31.15                     | \$19.81 | N/A                     | N/A       |
| ANNUAL              | \$42.73                     | \$19.81 | N/A                     | N/A       |
| 2012                |                             |         |                         |           |
| First Quarter       | \$37.44                     | \$28.95 | N/A                     | N/A       |
| Second Quarter      | \$39.73                     | \$35.18 | N/A                     | N/A       |
| Third Quarter       | \$38.76                     | \$29.03 | N/A                     | N/A       |
| Fourth Quarter      | \$35.92                     | \$31.11 | N/A                     | N/A       |
| ANNUAL              | \$39.73                     | \$28.95 | N/A                     | N/A       |

Most recent six months

|           |         |         |     |     |
|-----------|---------|---------|-----|-----|
| 2012      |         |         |     |     |
| October   | \$35.92 | \$31.11 | N/A | N/A |
| November  | \$33.04 | \$31.60 | N/A | N/A |
| December  | \$33.38 | \$31.91 | N/A | N/A |
| 2013      |         |         |     |     |
| January   | \$36.52 | \$33.40 | N/A | N/A |
| February  | \$37.00 | \$35.36 | N/A | N/A |
| March (*) | \$38.55 | \$36.08 | N/A | N/A |

\*Through March 24, 2013

B. Plan of Distribution

Not applicable.

C. Markets

Our ordinary shares are listed for quotation on the NASDAQ Global Select Market under the symbol “RDWR”.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

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

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

Objects and Purposes

Pursuant to our Articles of Association, our objective is to engage, directly or indirectly, in any lawful undertaking or business whatsoever, including, without limitation, as stipulated in our Memorandum of Association, which was filed with the Israeli Registrar of Companies.

Shares; Transfer of Shares

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

Dividend and Liquidation Rights

According to the Israeli Companies Law, a company may distribute dividends only out of its “profits,” as such term is defined in the Israeli Companies Law, as of the end of the most recent fiscal year or as accrued over a period of two years, whichever is higher. Our Board of Directors is authorized to declare dividends, provided that there is no reasonable concern that payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due, and provided further that our shareholders approve the final dividend declared by the Board of Directors, in an amount not to exceed the Board of Directors’ recommendation. Notwithstanding the foregoing, even where there are no sufficient profits, dividends may be paid with the approval of a court, provided that there is no reasonable concern that payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. Profits, for purposes of the Israeli Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years, after deduction of previous distributions that were not already deducted from the surplus, as evidenced by financial statements prepared no more than six months prior to the date of distribution.

In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to their respective holdings. This liquidation right may be affected by the grant of preferential dividends or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

## Voting, Shareholders' Meetings and Resolutions

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

In accordance with our Articles of Association, unless a longer period for notice is prescribed by the Israeli Companies Law, at least seven days and not more than forty-five days' notice of any general meeting of shareholders must be given. Under the Companies Law, shareholder meetings generally require prior notice of not less than 21 days or, with respect to certain matters, such as election of directors and affiliated party transactions, not less than 35 days.

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

The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or by proxy who hold or represent between them at least 35% of the outstanding voting shares unless otherwise required by applicable rules. A meeting adjourned for lack of a quorum, if convened upon requisition under the provisions of the Companies Law, shall be dissolved, but in any other case is adjourned to the same day in the following week at the same time and place or any time and place as the chairman may designate with the consent of a majority of the voting power represented at the meeting and voting on the matter adjourned. At such reconvened meeting, the required quorum consists of any two members present in person or by proxy.

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

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

#### General Duties of Shareholders

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

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of certain related party transactions and actions, which require shareholder approval pursuant to the Companies Law.

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

Furthermore, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the articles of association, has the power to appoint or to prevent the appointment of an office holder in the company or any other power toward the company is under a duty to act in fairness towards the company. These various shareholder duties may restrict the ability of a shareholder to act in what the shareholder perceives to be its own best interests.

#### Restrictions on Non-Israeli Residents

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



Association or by the laws of the State of Israel.

#### Mergers and Acquisitions under Israeli Law

There are no specific provisions of our Memorandum or Articles of Association that would have an effect of delaying, deferring or preventing a change in control of us or that would operate only with respect to a merger, acquisition or corporate restructuring involving us (or any of our subsidiaries), except those relating to the staggered board as described in Item 6 above and certain provisions of the Companies Law described below, which may have such effect.

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

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

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

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. In general, if less than 5% of the outstanding shares are not tendered in the tender offer and more than half of the offerees who have no personal interest in the offer tendered their shares, all the shares that the acquirer offered to purchase will be transferred to it. Shareholders may request appraisal rights in connection with a full tender offer for a period of six months following the consummation of the tender offer, but the acquirer is entitled to stipulate that tendering shareholders will forfeit such appraisal rights.

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

#### Modification of Class Rights

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

#### Board of Directors

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

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

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

#### Exculpation, Insurance and Indemnification

##### Exculpation of Office Holders

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

##### Insurance of Office Holders

As permitted by the Companies Law, our Articles of Association provide that we may enter into a contract for the insurance of the liability of any of our office holders, with respect to an act performed in the capacity of an office holder for:

- a breach of his or her duty of care to us or to another person;
- a breach of his or her duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice our interests;
- a financial liability imposed upon him or her in favor of another person;
- expenses he or she incurs as a result of administrative proceedings that may be instituted against him or her under Israeli securities laws, if applicable, and payments made to injured persons under specific circumstances thereunder; and
- any other matter in respect of which it is permitted or will be permitted under applicable law to insure the liability of an office holder in the Company.

##### Indemnification of Office Holders

As permitted by the Companies Law, our Articles of Association provide that we may indemnify any of our office holders against the following obligations and expenses imposed on the office holder with respect to an act performed in the capacity of an office holder:

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a financial liability incurred by, or imposed on him or her in favor of another person by a court judgment, including a settlement or an arbitration award approved by the court. Such indemnification may be approved (i) after the liability has been incurred or (ii) in advance, provided that our undertaking to indemnify is limited to events that our Board of Directors believes are foreseeable in light of our actual operations at the time of providing the undertaking and to a sum or criterion that our Board of Directors determines to be reasonable under the circumstances;

- reasonable litigation expenses, including attorney's fees, expended by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding either (A) concluded without the filing of an indictment against him or her or (B) concluded with the imposition of financial liability in lieu of criminal proceedings other than with respect to a criminal offense that does not require proof of criminal intent or in connection with a financial sanction;
- reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him or her by a court in connection with proceedings we institute against him or her or instituted on our behalf or by another person, a criminal indictment from which he or she was acquitted, or a criminal indictment in which he or she was convicted for a criminal offense that does not require proof of criminal intent;
- expenses he or she incurs as a result of administrative proceedings that may be instituted against him or her under Israeli securities laws, if applicable, and payments made to injured persons under specific circumstances thereunder; and
- any other matter in respect of which it is permitted or will be permitted under applicable law to indemnify an office holder in the Company.

#### Limitations on Insurance and Indemnification

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

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

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

We currently hold directors and officers liability insurance for the benefit of our office holders with an aggregate coverage limit of \$15 million. In addition, we provide our directors and officers indemnification pursuant to the terms of a Letter of Indemnification substantially in the form approved by our shareholders.

#### C. Material Contracts

See the summary of the terms of the Headquarters Lease in "Item 7B – Major Shareholders and Related Party Transactions – Related Party Transactions – Lease of Property".

#### D. Exchange Controls

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

## E. Taxation

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

### Israeli Tax Considerations

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

#### General Corporate Tax Structure

Generally, Israeli companies are subject to “Corporate Tax” on their taxable income at the rate of 24% for the 2011 tax year and 25% for the 2012 and 2013 tax years. Following an amendment to the Tax Ordinance, which came into effect on January 1, 2012, the Corporate Tax rate is scheduled to remain at a rate of 25% for future tax years. Israeli companies are generally subject to Capital Gains Tax at the corporate tax rate. However, the effective tax rate payable by a company which derives income from an approved enterprise (as further discussed below) may be considerably less.

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

##### The law before the amendment of 2005

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

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



price index linkage adjustment and interest.

The benefit period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income (after the commencement of production), and is limited to twelve years from commencement of production or 14 years from the start of the tax year in which approval is obtained, whichever is earlier (the “Years Limitation”).

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

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

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

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

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

#### The 2005 Amendment to the Investments Law

An amendment to the Investments Law, which was published on April 1, 2005 (the "Amendment"), changed certain provisions of the Law. As a result of the Amendment, a company is no longer obliged to obtain Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions, and therefore generally there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, the Company may claim the tax benefits offered by the Investments Law directly in its tax returns by notifying the ITA within 12 months of the end of that year, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

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

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

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

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

We elected 2009 and 2012 as years of election according to the law prior to the reform mentioned below.

#### Reform of the Investments Law

On December 29, 2010, the Israeli parliament approved an amendment to the Investments Law, effective as of January 1, 2011, which constitutes a reform of the incentives regime under such law.

The amendment generally abolishes the previous tax benefit routes that were afforded under the Investment Law, specifically the tax-exemption periods previously allowed, and introduces new tax benefits for industrial enterprises meeting the criteria of the law, which include the following:

- A reduced corporate tax rate for industrial enterprises, provided that more than 25% of their annual income is derived from export, which will apply to the enterprise's entire preferred income so that in the tax years 2011 and 2012 the reduced tax rate will be 10% for preferred income derived from industrial facilities located in development area A and 15% for those located elsewhere in Israel, in the tax years 2013 and 2014 the reduced tax rate will be 7% for development area A and 12.5% for the rest of Israel, and in the tax year 2015 and onwards the reduced tax rate will be 6% for development area A and 12% for the rest of Israel.
- The reduced tax rates will no longer be contingent upon making a minimum qualifying investment in productive assets.
- A definition of "preferred income" was introduced into the Investments Law to include certain types of income that are generated by the Israeli production activity of a preferred enterprise.
- A reduced dividend withholding tax rate of 15% will apply to dividends paid from preferred income to both Israeli and non-Israeli investors, with an exemption from such withholding tax applying to dividends paid to an Israeli company.

A "Preferred Company" (as defined in the Investments Law) may generally elect to apply the provisions of the amendment to preferred income produced or generated by it commencing on January 1, 2011. The amendment provides various transition provisions which allow, under certain circumstances, to apply the new regime to investment programs previously approved or elected under the Investments Law in its previous form.

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

A recent amendment to the Investment Law became effective on November 12, 2012 and provides temporary tax relief on the amount of tax which should have been paid on distributable tax exempt earnings, in order to encourage companies to pay the reduced taxes during the following 12 months. Pursuant to the amendment, companies may elect by November 11, 2013 to pay a reduced corporate tax rate with respect to undistributed exempt Approved or Privileged income, accumulated up until December 31, 2011. An election to release a greater amount of the total accumulated exempt earnings will result in a higher relief from the corporate income tax, reflecting a tax rate ranging from 6% to 17.5%.

The reduced corporate tax is payable within 30 days of making the election. Following the payment of the reduced corporate taxes, companies that elect to adopt the amendment will be entitled to distribute dividends from such income, without being required to pay any further corporate taxes with respect to such dividends. The amendment does not require an actual distribution of the retained earnings, nor does it provide any relief from the dividend withholding tax. Companies that have made this election must make certain qualified investments in Israel over the five year period commencing 2013. Companies that have elected to apply the amendment cannot withdraw from the election.

The Investment Law treats certain payments made by a company from cash resources derived from tax exempt income, as a deemed dividend distribution event, triggering a corporate tax liability, at the regular Approved or Privileged income tax rates. Such payments include but are not limited to, repurchase of shares and payments made to substantial shareholders as defined in the Law. The above amendment to the Law stipulated that investments in subsidiaries including in the form of acquisition of subsidiaries from unrelated party, may be also considered as a deemed dividend distribution event, thus increasing the risk of triggering a deemed dividend distribution event and therefore a potential tax exposure. The ITA interpretation is that this provision applies retroactively to investments and acquisitions made prior to the amendment.

#### Captured Earnings – 2012 amendment

As explained above, under the Approved and Privileged Enterprise regimes, a company that pays a dividend out of income derived during the tax exemption period, referred to as Captured Earnings, will be subject to corporate tax in respect of the amount distributed at the rate which would have been applicable had the company not been exempt from tax under the aforementioned regimes.

On November 12, 2012, an amendment to the Investments Law was published which provided, under certain circumstances, reduced corporate tax rates applicable for Captured Earnings accumulated until December 31, 2011, which are distributed. The reduced corporate tax rates are determined in accordance with the amount of Captured Earnings which is distributed. In addition, the dividend recipient is taxed at the reduced rate of 15% under the aforementioned regimes.

Unless extended, the above amendment, which was published as a temporary provision, will apply to companies that elect to distribute Captured Earnings no later than the lapse of one year from the date of publication of the amendment.

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

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

- Deduction of purchases of know-how and patents over an eight-year period for tax purposes;

- Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies;
- Accelerated depreciation rates on equipment and buildings; and
- Deductions over a three-year period of expenses involved with the issuance and listing of shares on a recognized stock market.

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

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

#### Capital Gains Tax on Sales of Our Ordinary Shares

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

Generally, as of January 1, 2012, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 30%. Additionally, if such shareholder is considered a “significant shareholder” at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 30%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement). Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of listed shares.

As of January 1, 2013, shareholders that are individuals who have taxable income that exceeds NIS 800,000 in a tax year (linked to the CPI each year), will be subject to an additional tax, referred to as High Income Tax, at the rate of 2% on their taxable income for such tax year which is in excess of NIS 800,000. For this purpose taxable income will include taxable capital gains from the sale of our shares and taxable income from dividend distributions.

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

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



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

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

## Taxation of Dividends paid to Non-Resident Holders of Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends. On distributions of dividends other than bonus shares, or stock dividends, income tax is applicable at the rate of 25%, or 30% for a shareholder that is considered a “significant shareholder” at any time during the 12-month period preceding such distribution, unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence. However, under the Investments Law, dividends generated by an Approved Enterprise, Benefited Enterprise or Preferred Enterprise, are taxed at the rate of 15%.

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

## United States Federal Income Tax Considerations

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

- An individual citizen or resident of the United States for U.S. federal income tax purposes;
- A corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States or any political subdivision thereof or the District of Columbia;
- An estate, the income of which is subject to U.S. federal income tax regardless of its source; or
- A trust (i) if, in general a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions, or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

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

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

- Are broker-dealers or insurance companies;

- Have elected mark-to-market accounting;
- Are tax-exempt organizations or retirement plans;

- Are grantor trusts;
- Are S corporations;
- Are financial institutions or “financial services entities” ;
- Hold their shares as part of a straddle, “hedge” or “conversion transaction” with other investments;
- Certain former citizens or long-term residents of the United States;
- Acquired their shares upon the exercise of employee stock options or otherwise as compensation;
- Are real estate investment trusts or regulated investment companies;
- Own directly, indirectly or by attribution at least 10% of our voting power; or
- Have a functional currency that is not the U.S. dollar.

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds our ordinary shares, the tax treatment of the partnership and a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such a partner or partnership should consult its own tax advisor as to its tax consequences.

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

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

#### Taxation of Ordinary Shares

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

Dividends that are received by non-corporate U.S. Holders will generally be taxed at the rate applicable to long-term capital gains (currently a maximum rate of 20% for taxable years beginning after December 31, 2012), provided that such dividends meet the requirements of “qualified dividend income.” Dividends that fail to meet such requirements, and dividends received by corporate U.S. Holders, are taxed at ordinary income rates. No dividend received by a U.S. Holder will be a qualified dividend (1) if the U.S. Holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code Section 246(c), any period during which the U.S. Holder has an option to sell, is under a contractual obligation to sell, has made and not closed a

short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. Holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a “passive foreign investment company” (as such term is defined in the Code) for any year, dividends paid on our ordinary shares in such year or in the following year would not be qualified dividends. In addition, a non-corporate U.S. Holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

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

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

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

**Medicare Tax.** With respect to taxable years beginning after December 31, 2012, certain non-corporate U.S. holders will be subject to an additional 3.8% Medicare tax on all or a portion of their "net investment income," which may include dividends on, or capital gains recognized from the disposition of, our ordinary shares. U.S. holders are urged to consult their own tax advisors regarding the implications of the additional Medicare tax on their investment in our ordinary shares.

**Passive Foreign Investment Company Status.** We will be a passive foreign investment company (a "PFIC") if (taking into account certain "look-through" rules with respect to the income and assets of our corporate subsidiaries) either (i) 75 percent or more of our gross income in a taxable year is passive income or (ii) the average percentage (by value, determined on a quarterly basis) of our total assets that are passive assets during the taxable year is at least 50 percent. If we were a PFIC, each U.S. Holder would (unless it made one of the elections discussed below on a timely basis) be taxable on gain recognized from the disposition of our ordinary shares (including gain deemed recognized if the ordinary shares are used as security for a loan) and upon receipt of certain distributions with respect to our ordinary shares as if such income had been recognized ratably over the U.S. Holder's holding period for the ordinary shares. The U.S. Holder's income for the current taxable year would include (as ordinary income) amounts allocated

to the current year and to any period prior to the first day of the first taxable year for which we were a PFIC. Tax would also be computed at the highest ordinary income tax rate in effect for each other period to which income is allocated, and an interest charge on the tax as so computed would also apply. Additionally, if we were a PFIC, U.S. Holders who acquire our ordinary shares from decedents (other than certain nonresident aliens) would be denied the normally-available step-up in basis for such shares to fair market value on the date of death and, instead, would generally have a tax basis in such shares equal to the lower of the decedent's basis or the fair market value of such shares on the date of the decedent's death. Further, if we are a PFIC, each U.S. Holder will generally be required to file an annual report with the IRS.

As an alternative to the tax treatment described above, a U.S. Holder could elect to treat us as a “qualified electing fund” (“QEF”), in which case the U.S. Holder would be required to include in income, for each taxable year that we are a PFIC, its pro rata share of our ordinary earnings as ordinary income and its pro rata share of our net capital gain as long-term capital gain, subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. Any income inclusion will be required whether or not such U.S. Holder owns our ordinary shares for an entire taxable year or at the end of our taxable year. The amount so includable will be determined without regard to our prior year losses or the amount of cash distributions, if any, received from us. Special rules apply if a U.S. Holder makes a QEF election after the first year in its holding period in which we are a PFIC. We will supply U.S. Holders with the information needed to report income and gain under a QEF election if we are a PFIC. A U.S. Holder’s basis in its ordinary shares will increase by any amount included in income and decrease by any amounts not included in income when distributed because such amounts were previously taxed under the QEF rules. So long as a U.S. Holder’s QEF election is in effect beginning with the first taxable year in which we were a PFIC during the U.S. Holder’s holding period for its ordinary shares, any gain or loss realized by such holder on the disposition of its ordinary shares held as a capital asset ordinarily would be a capital gain or loss. Such capital gain or loss ordinarily would be long-term if such U.S. Holder had held such ordinary shares for more than one year at the time of the disposition. The QEF election is made on a shareholder-by-shareholder basis, applies to all ordinary shares held or subsequently acquired by an electing U.S. Holder and can be revoked only with the consent of the IRS.

As an alternative to making a QEF election, a U.S. Holder of PFIC stock which is “marketable stock” (e.g., “regularly traded” on the NASDAQ Global Select Market) may in certain circumstances avoid certain of the tax consequences generally applicable to holders of stock in a PFIC by electing to mark the stock to market as of the beginning of such U.S. Holder’s holding period for the ordinary shares. As a result of such election, in any taxable year that we are a PFIC, a U.S. Holder would generally be required to report gain or loss to the extent of the difference between the fair market value of the ordinary shares at the end of the taxable year and such U.S. Holder’s tax basis in its ordinary shares at that time. Any gain under this computation, and any gain on an actual disposition of the ordinary shares in a taxable year in which we are a PFIC, would be treated as ordinary income. Any loss under this computation, and any loss on an actual disposition of the ordinary shares in a taxable year in which we are a PFIC, generally would be treated as ordinary loss to the extent of the cumulative net-mark-to-market gain previously included. Any remaining loss from marking ordinary shares to market will not be allowed, and any remaining loss from an actual disposition of ordinary shares generally would be capital loss. A U.S. Holder’s tax basis in its ordinary shares is adjusted annually for any gain or loss recognized under the mark-to-market election. There can be no assurances that there will be sufficient trading volume with respect to the ordinary shares for the ordinary shares to be considered “regularly traded” or that our ordinary shares will continue to trade on the NASDAQ Global Select Market. Accordingly, there are no assurances that the ordinary shares will be marketable stock for these purposes. As with a QEF election, a mark-to-market election is made on a shareholder-by-shareholder basis, applies to all ordinary shares held or subsequently acquired by an electing U.S. Holder and can only be revoked with consent of the IRS (except to the extent the ordinary shares no longer constitute “marketable stock”).

As indicated above, we will be a PFIC for any taxable year if the average percentage (by fair market value determined on a quarterly basis) of our assets held for the production of, or that produce, passive income is at least 50 percent. The Code does not specify how a corporation must determine the fair market value of its assets for this purpose and the issue has not been definitively determined by the IRS or the courts. The market capitalization approach has generally been used to determine the fair market value of the assets of a publicly traded corporation. The IRS and the courts, however, have accepted other valuation methods besides the market capitalization approach in certain other valuation contexts. For our 2012 taxable year, we believe that we should not be classified as a PFIC. However, there can be no assurance that the IRS will not challenge this treatment and it is possible that the IRS could attempt to treat us as a PFIC for 2012 and possibly prior taxable years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of our future income and assets, and the future price of our ordinary shares which are all relevant to this determination of whether we are classified as a PFIC. Accordingly, there can be no



assurance that we will not become a PFIC in 2013 or in other future taxable years.

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

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

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

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

#### Information Reporting and Backup Withholding

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

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

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

#### F. Dividends and Paying Agents

Not applicable.

#### G. Statement by Experts

Not applicable.

#### H. Documents on Display

We are subject to the informational requirements of the Exchange Act, applicable to foreign private issuers and fulfill the obligations with respect to such requirements by filing reports with the SEC. You may read and copy any document we file with the SEC without charge at the SEC’s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the SEC at such

address, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Such materials are also available free of charge at the website of the SEC at [www.sec.gov](http://www.sec.gov).

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

We post our Annual Report on Form 20-F on our web site ([www.radware.com](http://www.radware.com)) as soon as practicable following the filing of the Annual Report on Form 20-F with the SEC.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including fluctuations in interest rates and foreign currency exchange rates. Our primary market risk exposure occurs because we generate a portion of our revenues in Euro and incur a portion of our expenses in NIS and in Euro. We do not presently engage in any hedging or other transactions intended to manage risks relating to foreign currency exchange rate or interest rate fluctuations.

In addition, as of December 31, 2012, we had cash and cash equivalents, including short-term and long-term bank deposits and marketable securities, of \$274.9 million. As of that date, approximately 99% of our cash, cash equivalents and marketable securities are held by Radware Ltd. in Israeli or U.S. financial institutions.

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

Exposure to Interest Rate Fluctuations

We do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk, with the exception of the following:

Approximately half of our cash throughout the world is invested in fixed-income securities and is affected by changes in interest rates. Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic and international economic and political conditions. These securities are readily available for sale and are treated as such in our financial statements.

A decline in market interest rates, such as the significant global decline in 2008 and 2009, which continued through 2012, has had an adverse effect on our investment income. This is because, in a declining interest rate environment, borrowers may seek to refinance their borrowings at lower rates and, accordingly, prepay or redeem securities held earlier than initially expected. This action may cause us to reinvest the redeemed proceeds in lower yielding investments. Currently, approximately 2% of our marketable securities portfolio can be redeemed early. An increase in market interest rates could also have an adverse effect on the value of our investment portfolio, for example, by decreasing the fair values of the fixed income securities that comprise a substantial majority of our investment portfolio.

Our investments consist primarily of government and corporate debentures and bank deposits. As of December 31, 2012, approximately 32% of our portfolio was invested in foreign banks and government debentures, 17% in other corporate debentures and the rest of the funds were invested in bank deposits and money market funds. Although we believe that we generally adhere to conservative investment guidelines, the continuing turmoil in the financial markets may result in impairments of the carrying value of our investment assets. Realized losses in our investments portfolio may adversely affect our financial position and results.

Any significant decline in our investment income or the value of our investments as a result of falling interest rates, deterioration in the credit of the securities in which we have invested, or general market conditions, could have an adverse effect on our results of operations and financial condition.

We currently have no debt.

## Exposure to Currency Fluctuations

Approximately 85% of our sales are denominated in dollars or are dollar-linked and we incur most of our expenses in dollars, NIS, and Euros. We believe that the dollar is the primary currency of the economic environment in which we operate. Thus, our functional and reporting currency is the dollar and monetary accounts maintained in currencies other than the dollar are re-measured into U.S. dollars in accordance with ASC No. 830 “Foreign Currency Matters”. Changes in currency exchange rates between our functional currency and the currency in which a transaction is denominated are included in our results of operations as financial income (expense) in the period in which the currency exchange rates change.

Our revenues and expenses may be affected by fluctuations in the value of the dollar as it relates to foreign currencies, mainly the Euro and the NIS. For example, if there were no changes in the average exchange rates of the dollar relative to the Euro and to the NIS during the year in 2012 compared to the average exchange rates in 2011, our revenues would have been higher in an amount of \$1.4 million and our expenses would have been higher in an amount of \$4.1 million. Assuming our revenues and expenses in 2013 remain at the same level and with the same currency mix as in 2012, a 10% weakening in the value of the dollar relative to all currencies in which we operate would result in an increase in revenues of \$2.8 million and an increase in our expenses of \$7.9 million.

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

| Year ended December 31, | U.S. dollar<br>against<br>NIS |    | U.S. dollar<br>against<br>Euro |    |
|-------------------------|-------------------------------|----|--------------------------------|----|
| 2007                    | (9.0                          | )% | (10.5                          | )% |
| 2008                    | (1.1                          | )% | 5.6                            | %  |
| 2009                    | (0.7                          | )% | (3.3                           | )% |
| 2010                    | (6.0                          | )% | 8.0                            | %  |
| 2011                    | 7.7                           | %  | 3.3                            | %  |
| 2012                    | (2.3                          | )% | (2.0                           | )% |
| 2013 (1)                | (1.0                          | )% | 0.7                            | %  |

(1) January 1, 2013 through March 10, 2013

## ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

### ITEMS 12A, 12B AND 12C

Not applicable.

### ITEM 12D

The Company does not have any outstanding American Depositary Shares or American Depositary Receipts.

## PART II

### ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

### ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

#### ITEMS 14A, 14B, 14C AND 14D

Not applicable.

#### ITEM 14E

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

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

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

### ITEM 15. CONTROLS AND PROCEDURES

#### a. Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of December 31, 2012. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2012, our disclosure controls and procedures were effective to ensure that: (1) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (2) such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

b. Management's Annual Report on Internal Control Over Financial Reporting and Attestation Report of Registered Public Accounting Firm

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting for us. Our internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets,



- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In conducting its assessment of internal control over financial reporting, our management based its evaluation on the framework in “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our management has concluded based on its assessment, that our internal control over financial reporting was effective as of December 31, 2012 based on these criteria.

The effectiveness of our internal control over financial reporting as of December 31, 2012, has been audited by Kost, Forer, Gabbay & Kasierer (A Member of Ernst & Young Global), an independent registered public accounting firm who audited and reported on the consolidated financial statements of the company for the year ended December 31, 2012.

c. Attestation Report of the Registered Public Accounting Firm

This annual report includes an attestation report of our registered public accounting firm regarding internal control over financial reporting on page F-3 of our audited consolidated financial statements set forth in “Item 18 – Financial Statements”, and incorporated herein by reference.

d. Changes In Internal Control Over Financial Reporting

During the period covered by this annual report, no changes in our internal control over financial reporting have occurred that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Mr. Avraham Asheri, a member of our Audit Committee, is a financial expert as defined in the applicable regulations, and has determined that such member is “independent” as such term is defined in the NASDAQ listing standards. The education and experience of the Audit Committee financial expert is presented in “Item 6 – Directors, Senior Management and Employees – Directors and Senior Management” and is incorporated herein by reference.

ITEM 16B. CODE OF ETHICS

We have adopted a Code of Conduct and Ethics which applies to all directors, officers and employees of the Company, including our Chief Executive Officer and President, Chief Financial Officer, Director of Finance and Corporate Controller. Our Code of Conduct and Ethics has been posted on our Internet website, <http://www.radware.com/content/company/investorrelations>.



## ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In the annual meeting held on November 8, 2012, our shareholders re-appointed Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global (“Ernst & Young”), to serve as our independent auditors until the next annual meeting.

Fees for professional services provided by our independent auditors in each of the last two fiscal years in each of the following categories are:

|                    | Year Ended December 31, |     |    |      |     |          |
|--------------------|-------------------------|-----|----|------|-----|----------|
|                    | 2011                    |     |    | 2012 |     |          |
|                    | (US\$ in thousands)     |     |    |      |     |          |
| Audit Fees         | \$                      | 279 | 72 | %    | \$  | 259 64 % |
| Audit-Related Fees | -                       | -   | -  | -    | -   | -        |
| Tax Fees           | 109                     | 28  | %  | 142  | 36  | %        |
| All Other Fees     | -                       | -   | -  | -    | -   | -        |
| Total              | 388                     | 100 | %  | 401  | 100 | %        |

Audit Fees include fees associated with the annual audit, including the audit of internal control over financial reporting, the reviews of the Company's quarterly financial statements, statutory audits required internationally, consents and assistance with and review of documents filed with the SEC.

Audit-Related Fees principally included due diligence in connection with acquisitions.

Tax Fees included tax compliance, including the preparation of tax returns, tax planning and tax advice, including assistance with tax audits and appeals, advice related to acquisitions, transfer pricing and assistance with respect to requests for rulings from tax authorities.

Audit Committee's pre-approval policies and procedures

Our Audit Committee oversees our independent auditors. See also the description in “Item 6C- Directors, Senior Management and Employee - Board Practices.”

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

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

None.

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

None.

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ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

We are a foreign private issuer whose ordinary shares are listed on the NASDAQ Global Select Market. As such, we are required to comply with U.S. federal securities laws, including the Sarbanes-Oxley Act, and the NASDAQ rules, including the NASDAQ corporate governance requirements. The NASDAQ rules provide that foreign private issuers may follow home country practice in lieu of certain qualitative listing requirements subject to certain exceptions and except to the extent that such exemptions would be contrary to U.S. federal securities laws, so long as the foreign issuer discloses that it does not follow such listing requirement and describes the home country practice followed in its reports filed with the SEC. Below is a concise summary of the significant ways in which our corporate governance practices differ from the corporate governance requirements of NASDAQ applicable to domestic U.S. listed companies:

The NASDAQ rules require that an issuer have a quorum requirement for shareholders meetings of at least one-third of the outstanding shares of the issuer's common voting stock. We have chosen to follow home country practice with respect to the quorum requirements of an adjourned shareholders meeting. Our articles of association, as permitted under the Israeli Companies Law and Israeli practice, provide that the quorum requirements for an adjourned meeting are the presence of a minimum of two shareholders present in person.

The NASDAQ rules require shareholder approval of stock option plans available to officers, directors or employees. We have decided to follow home country practice in lieu of obtaining shareholder approval for our stock option plans. However, subject to exceptions permitted under the Companies Law, we are required to seek shareholder approval of any grants of options to directors and controlling shareholders or plans that require shareholder approval for other reasons. Additionally, we have chosen to follow our home country practice in lieu of the requirements of NASDAQ Rule 5250(d)(1), relating to an issuer's furnishing of its annual report to shareholders. Specifically, we file annual reports on Form 20-F, which contain financial statements audited by an independent accounting firm, electronically with the SEC and post a copy on our website.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

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

ITEM 18. FINANCIAL STATEMENTS

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

ITEM 19. EXHIBITS

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

| Exhibit No. | Exhibit  |
|-------------|--|
| 1.1         | Memorandum of Association ¶ (A)  |
| 1.2         | Amended and Restated Articles of Association (B)   |
| 4.1         | Form of Directors and Officers Indemnity Deed (C)  |
| 4.2         | Lease Agreement for the Company's Mahwah office (D)  |
| 4.3         | Distributor Agreement with Bynet Data Communications Ltd. (D)  |
| 4.4         | Summary of Material Terms of the Lease Agreements for the Company's Headquarters*  |
| 4.6         | 1997 Key Employee Share Incentive Plan, as amended and restated*   |
| 4.7         | 2010 Addendum (for international grantees) (E)   |
| 4.8         | Radware Ltd. – 2010 Employee Share Purchase Plan (F)   |
| 8.1         | List of Subsidiaries*  |
| 12.1        | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*  |
| 12.2        | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*  |
| 13.1        | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002* |
| 13.2        | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002* |
| 15.1        | Consent of Independent Registered Public Accounting Firm*  |

¶ Translated from Hebrew

\* Filed herewith.

(A) Incorporated by reference to Exhibit 1.1 to the Annual Report on Form 20-F for the year ended December 31, 2011, filed with the SEC on March 28, 2012.

(B) Incorporated by reference to Exhibit 1.2 to the Annual Report on Form 20-F for the year ended December 31, 2011, filed with the SEC on March 28, 2012.

(C) Incorporated by reference to Annex B to the Proxy Statement filed as Exhibit 1.2 to Report of Foreign Private Issuer on Form 6-K submitted to the SEC on July 28, 2011.

(D) Incorporated by reference to Exhibit 4.3 to the Annual Report on Form 20-F for the year ended December 31, 2001, filed with the SEC on April 5, 2002.

(E) Incorporated by reference to Exhibit 4.8 to the Annual Report on Form 20-F for the year ended December 31, 2009, filed with the SEC on April 29, 2010.

(F) Incorporated by reference to Exhibit 4.9 to the Annual Report on Form 20-F for the year ended December 31, 2009, filed with the SEC on April 29, 2010.





SIGNATURE

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

RADWARE LTD.

By: /s/ Roy Zisapel  
Roy Zisapel  
Chief Executive Officer

Date: March 28, 2013

RADWARE LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2012

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

RADWARE LTD.

We have audited the accompanying consolidated balance sheets of Radware Ltd. and its subsidiaries ("the Company") as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 28, 2013 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
March 28, 2013

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders of

RADWARE LTD.

We have audited Radware Ltd.'s (the "Company") and its subsidiaries internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012 and our report dated March 28, 2013 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
March 28, 2013

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

## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

|   | December 31, |           |
|---|--------------|-----------|
|   | 2011         | 2012      |
| <b>ASSETS</b>   |              |           |
| <b>CURRENT ASSETS:</b>  |              |           |
| Cash and cash equivalents   | \$17,386     | \$20,048  |
| Available-for-sale marketable securities  | 10,334       | 14,004    |
| Short-term bank deposits  | 88,773       | 54,155    |
| Trade receivables (net of allowance for doubtful accounts and sales reserves in a total amount of \$ 1,440 and \$ 1,641 in 2011 and 2012, respectively) | 12,565       | 18,408    |
| Other current assets and prepaid expenses   | 3,218        | 3,975     |
| Inventories   | 12,147       | 12,545    |
| Total current assets  | 144,423      | 123,135   |
| <b>LONG-TERM INVESTMENTS:</b>   |              |           |
| Available-for-sale marketable securities  | 102,644      | 121,114   |
| Long-term bank deposits   | -            | 65,625    |
| Severance pay fund  | 3,047        | 2,957     |
| Total long-term investments   | 105,691      | 189,696   |
| Property and equipment, net   | 11,084       | 13,589    |
| Intangible assets, net  | 8,163        | 5,128     |
| Goodwill  | 24,465       | 24,465    |
| Other assets  | 1,365        | 1,637     |
| Total assets  | \$295,191    | \$357,650 |

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

## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

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

|   | December 31, |           |
|---|--------------|-----------|
|   | 2011         | 2012      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                     |              |           |
| <b>CURRENT LIABILITIES:</b>   |              |           |
| Trade payables  | \$5,099      | \$9,915   |
| Deferred revenues   | 35,516       | 36,304    |
| Employees and payroll accruals  | 7,748        | 6,559     |
| Other payables and accrued expenses   | 6,984        | 13,742    |
| Total current liabilities   | 55,347       | 66,520    |
| <b>LONG TERM LIABILITIES:</b>   |              |           |
| Deferred revenues   | 16,978       | 16,486    |
| Other long term liabilities   | 3,545        | 3,414     |
| Total long term liabilities   | 20,523       | 19,900    |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES</b>                                   |              |           |
| <b>SHAREHOLDERS' EQUITY:</b>  |              |           |
| Share capital -   |              |           |
| Ordinary shares of NIS 0.1 par value -  |              |           |
| Authorized: 30,000,000 at December 31, 2011 and 2012; Issued:                   |              |           |
| 23,046,257 and 23,981,409 shares at December 31, 2011 and                       |              |           |
| 2012, respectively; Outstanding: 21,250,300 and 22,185,452                      |              |           |
| shares at December 31, 2011 and 2012, respectively                              |              |           |
|   | 574          | 599       |
| Additional paid-in capital  | 233,353      | 249,739   |
| Treasury stock (1,795,957 shares of common stock at December 31, 2011 and 2012) | (18,082 )    | (18,082 ) |
| Accumulated other comprehensive income (loss)                                   | (1,663 )     | 2,078     |
| Retained earnings   | 5,139        | 36,896    |
| Total shareholders' equity  | 219,321      | 271,230   |
| Total liabilities and shareholders' equity                                      | \$295,191    | \$357,650 |

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

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## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

|                                | 2010     | Year ended<br>December 31,<br>2011 | 2012      |
|--------------------------------|----------|------------------------------------|-----------|
| Revenues:                      |          |                                    |           |
| Products                       | \$89,358 | \$103,285                          | \$119,279 |
| Services                       | 54,761   | 63,735                             | 69,892    |
| Total revenues                 | 144,119  | 167,020                            | 189,171   |
| Cost of revenues:              |          |                                    |           |
| Products                       | 21,306   | 24,231                             | 26,386    |
| Services                       | 7,898    | 9,126                              | 9,333     |
| Total cost of revenues         | 29,204   | 33,357                             | 35,719    |
| Gross profit                   | 114,915  | 133,663                            | 153,452   |
| Operating expenses:            |          |                                    |           |
| Research and development, net  | 31,660   | 36,064                             | 36,187    |
| Sales and marketing            | 64,609   | 69,543                             | 76,646    |
| General and administrative     | 10,190   | 9,629                              | 9,696     |
| Total operating expenses       | 106,459  | 115,236                            | 122,529   |
| Operating income               | 8,456    | 18,427                             | 30,923    |
| Financial income, net          | 2,057    | 4,200                              | 4,792     |
| Income before taxes on income  | 10,513   | 22,627                             | 35,715    |
| Taxes on income                | 879      | 1,290                              | 3,958     |
| Net income                     | \$9,634  | \$21,337                           | \$31,757  |
| Basic net earnings per share   | \$0.49   | \$1.02                             | \$1.45    |
| Diluted net earnings per share | \$0.44   | \$0.93                             | \$1.36    |

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

## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

|  | 2010     | Year ended<br>December 31,<br>2011 | 2012     |
|--|----------|------------------------------------|----------|
| Net Income   | \$9,634  | \$21,337                           | \$31,757 |
| Other comprehensive income before tax:                                 |          |                                    |          |
| Unrealized gains (losses) on available-for-sale securities:            |          |                                    |          |
| Changes in unrealized gains  | (810 )   | (1,788 )                           | 4,455    |
| Less: reclassification adjustments for gains included in net income    | -        | -                                  | (21 )    |
| Other comprehensive income (loss) before tax                           | (810 )   | (1,788 )                           | 4,434    |
| Income tax expense related to components of other comprehensive income | -        | -                                  | (693 )   |
| Other comprehensive income (loss), net of tax                          | \$(810 ) | \$(1,788 )                         | \$3,741  |
| Comprehensive income   | \$8,824  | \$19,549                           | \$35,498 |

## RADWARE LTD. AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

|   | Number of<br>outstanding<br>Ordinary<br>shares | Share<br>capital | Additional<br>paid-in<br>capital | Treasury<br>stock, at<br>cost | Accumulated<br>other<br>comprehensive<br>income | Retained<br>earnings<br>(accumulated<br>deficit) | Total     |
|---|--|------------------|----------------------------------|-------------------------------|---|--|-----------|
| Balance as of<br>January 1, 2010                        | 18,916,601                                     | \$511            | \$191,941                        | \$(18,082 )                   | \$ 935  | \$ (25,832 )                                     | \$149,473 |
| Issuance of shares<br>upon exercise of<br>stock options | 1,543,972                                      | 41               | 21,159                           | -                             | -   | -  | 21,200    |
| Stock based<br>compensation                             | -  | -                | 5,493                            | -                             | -   | -  | 5,493     |
| Other<br>comprehensive<br>loss                          | -  | -                | -                                | -                             | (810 )  | -  | (810 )    |
| Net income  | -  | -                | -                                | -                             | -   | 9,634  | 9,634     |
| Balance as of<br>December 31,<br>2010                   | 20,460,573                                     | 552              | 218,593                          | (18,082 )                     | 125   | (16,198 )  | 184,990   |
| Issuance of shares<br>upon exercise of<br>stock options | 789,727  | 22               | 8,512                            | -                             | -   | -  | 8,534     |
| Stock based<br>compensation                             | -  | -                | 5,458                            | -                             | -   | -  | 5,458     |
| Tax benefit<br>related to exercise<br>of stock options  | -  | -                | 790                              | -                             | -   | -  | 790       |
| Other<br>comprehensive<br>loss                          | -  | -                | -                                | -                             | (1,788 )  | -  | (1,788 )  |
| Net income  | -  | -                | -                                | -                             | -   | 21,337   | 21,337    |
| Balance as of<br>December 31,<br>2011                   | 21,250,300                                     | 574              | 233,353                          | (18,082 )                     | (1,663 )  | 5,139  | 219,321   |
| Issuance of shares<br>upon exercise of<br>stock options | 935,152  | 25               | 10,631                           | -                             | -   | -  | 10,656    |
| Stock based<br>compensation                             | -  | -                | 5,383                            | -                             | -   | -  | 5,383     |

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|  |            |        |           |             |          |           |           |
|--|------------|--------|-----------|-------------|----------|-----------|-----------|
| Tax benefit<br>related to exercise<br>of stock options | -          | -      | 372       | -           | -        | -         | 372       |
| Other<br>comprehensive<br>income, net of tax           | -          | -      | -         | -           | 3,741    | -         | 3,741     |
| Net income   | -          | -      | -         | -           | -        | 31,757    | 31,757    |
| Balance as of<br>December 31,<br>2012                  | 22,185,452 | \$ 599 | \$249,739 | \$(18,082 ) | \$ 2,078 | \$ 36,896 | \$271,230 |

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

## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

|  | 2010      | Year ended<br>December 31,<br>2011 | 2012      |
|--|-----------|------------------------------------|-----------|
| Cash flows from operating activities:  |           |                                    |           |
| Net income   | \$9,634   | \$21,337                           | \$31,757  |
| Adjustments to reconcile net income to net cash provided by operating activities:                                      |           |                                    |           |
| Depreciation and amortization  | 9,052     | 10,299                             | 9,867     |
| Stock based compensation   | 5,493     | 5,458                              | 5,383     |
| Gain from sale of available-for-sale marketable securities   | -         | -                                  | (21 )     |
| Amortization of premiums, accretion of discounts and accrued interest on available-for-sale marketable securities, net | 1,877     | 3,652                              | 2,198     |
| Accrued interest on bank deposits  | (137 )    | (243 )                             | (354 )    |
| Decrease in accrued severance pay, net   | (591 )    | (59 )                              | (165 )    |
| Changes in deferred income taxes, net  | (5 )      | (1,358 )                           | (1,584 )  |
| Decrease (increase) in trade receivables, net  | 60        | 3,978                              | (5,843 )  |
| Decrease (increase) in other current assets and prepaid expenses   | (468 )    | 772                                | (1 )      |
| Decrease (increase) in inventories   | 70        | (2,425 )                           | (398 )    |
| Increase (decrease) in trade payables  | 214       | (814 )                             | 4,816     |
| Increase in deferred revenues  | 13,358    | 977                                | 296       |
| Increase in other payables and accrued expenses  | 2,409     | 1,206                              | 5,941     |
| Excess tax benefit from stock-based compensation   | -         | (790 )                             | (372 )    |
| Net cash provided by operating activities  | 40,966    | 41,990                             | 51,520    |
| Cash flows from investing activities:  |           |                                    |           |
| Purchase of property and equipment   | (5,650 )  | (5,734 )                           | (9,337 )  |
| Investment in other long-term assets   | (88 )     | (35 )                              | (13 )     |
| Investment in bank deposits  | (21,174 ) | (32,089 )                          | (30,653 ) |
| Purchase of available-for-sale marketable securities   | (75,814 ) | (68,777 )                          | (32,066 ) |
| Proceeds from redemption and maturity of available-for-sale marketable securities                                      | 37,201    | 57,423                             | 12,183    |
| Payment for acquisition of Intangible assets   | (1,200 )  | -                                  | -         |
| Net cash used in investing activities  | (66,725 ) | (49,212 )                          | (59,886 ) |

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



## RADWARE LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

|  | 2010      | Year ended<br>December 31,<br>2011 | 2012      |
|--|-----------|------------------------------------|-----------|
| Cash flows from financing activities:                  |           |                                    |           |
| Proceeds from exercise of stock options                | 21,200    | 8,534                              | 10,656    |
| Excess tax benefit from stock-based compensation       | -         | 790                                | 372       |
| Net cash provided by financing activities              | 21,200    | 9,324                              | 11,028    |
| Increase (decrease) in cash and cash equivalents       | (4,559 )  | 2,102                              | 2,662     |
| Cash and cash equivalents at the beginning of the year | 19,843    | 15,284                             | 17,386    |
| Cash and cash equivalents at the end of the year       | \$ 15,284 | \$ 17,386                          | \$ 20,048 |
| Supplemental disclosure of cash flow information:      |           |                                    |           |
| Cash paid during the year for income taxes             | \$ 719    | \$ 847                             | \$ 967    |

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

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 1:- GENERAL

- a. Radware Ltd. ("the Company"), an Israeli corporation commenced operations in April 1997. The Company and its subsidiaries ("the Group") are engaged in the development, manufacture and sale of Application Delivery and Application Security solutions that provide end-to-end availability, performance and security of business-critical network applications. The Company's products are marketed worldwide.
- b. The Company has established wholly-owned subsidiaries in the United States, France, Germany, Singapore, the United Kingdom, Japan, Korea, Canada, India, Australia Italy and China. The Company holds 91.9% of its Israeli subsidiary. In addition, the Company has established representative offices in China and Taiwan. The Company's subsidiaries are engaged primarily in sales, marketing and support activities.
- c. The Company depends on four major suppliers to supply certain components for the production of its products. If one of these suppliers fails to deliver or delays the delivery of the necessary components, the Company will be required to seek alternative sources of supply. A change in suppliers could result in manufacturing delays, which could cause a possible loss of sales and, consequently, could adversely affect the Company's results of operations and financial position.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

On an ongoing basis, the Company's management evaluates estimates, including those related to fair values and useful lives of intangible assets, tax assets and liabilities, fair values of stock-based awards, as well as in estimates used in applying the revenue recognition policy related to separation of multiple elements. Such estimates are based on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.



RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Financial statements in United States dollars:

A majority of the revenues of the Company and its subsidiaries are denominated in U.S. dollars ("dollar" or "dollars"). In addition, a substantial portion of the Company's and certain of its subsidiaries' costs are denominated in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar. Accordingly, monetary accounts maintained in currencies other than the dollar are re-measured into U.S. dollars in accordance with Accounting Standards Codification ("ASC") No. 830 "Foreign Currency Matters". Changes in currency exchange rates between the Company's functional currency and the currency in which a transaction is denominated are included in the Company's results of operations as financial income (expense) in the period in which the currency exchange rates change.

c. Principles of consolidation:

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

d. Cash equivalents:

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

e. Bank deposits:

Bank deposits with maturities of more than three months but less than one year are included in short-term deposits. Such short-term deposits are stated at cost which approximates market values.

Bank deposits with maturities of more than one year are included in long-term deposits. Such long-term deposits are stated at cost which approximates market values.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Investment in marketable securities:

The Company accounts for investments in marketable debt securities in accordance with ACS No. 320, "Investments- Debt and equity Securities". Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date.

The Company classified all of its debt securities as available-for-sale securities. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sales of investments are included in financial income, net and are derived using the specific identification method for determining the cost of securities.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization together with interest and dividends on securities are included in financial income, net.

The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. The factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period and the Company's intent to sell, including whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For securities that are deemed other-than-temporarily impaired, the amount of impairment recognized in the statement of income (operations) is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. During the years 2010, 2011 and 2012, the Company did not record any other-than-temporary impairment loss with respect to its marketable securities.

g. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-off is provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories and discontinued products. Inventory write-off totaled \$ 255, \$ 1,205 and \$ 1,147 in 2010, 2011 and 2012, respectively, and has been included in cost of revenues.

Cost is determined as follows:

Raw materials and components - using the "first-in, first-out" method.

Work-in-progress and finished products - raw materials as above with the addition of subcontracting costs - calculated on the basis of direct subcontractors costs and with direct overhead costs.



## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

## h. Property and equipment:

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

|   | %  |
|---|--|
| Computer, peripheral equipment and software | 15 - 33 (mainly 33 )   |
| Office furniture and equipment              | 6 - 20 (mainly 15)   |
| Leasehold improvements                      | Over the shorter of the term of<br>the lease or the useful life of the asset |

## i. Impairment of long lived assets and intangible assets subject to amortization:

Property and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with ASC No. 360, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Intangible assets acquired in a business combination are recorded at fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets that are not considered to have an indefinite useful life are amortized over their estimated useful lives, which range from 1 to 7 years. Some of the acquired customer arrangements are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in accelerated amortization of such customer arrangements as compared to the straight-line method. All other intangible assets are amortized over their estimated useful lives on a straight-line basis.

During 2010, 2011 and 2012, no impairment losses were recorded.

## RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

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

## j. Goodwill:

Goodwill reflects the excess of the purchase price of business acquired over the fair value of net assets acquired. Goodwill is not amortized but instead is tested for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

In accordance with ASC No. 350 the Company performs an annual impairment test at December 31 each year. The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, the second step would need to be performed; otherwise, no further step is required. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value. During the years ended December 31, 2010, 2011 and 2012, no impairment losses were recorded.

## k. Revenue recognition:

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

Revenues from product sales are recognized in accordance with ASC No. 605, "Revenue Recognition" when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, and collectability is reasonably assured.

Revenue derived from post-contract customer support, which represents mainly software updates, help desk support, unit replacement or repair, and security update service is recognized ratably over the contract period, which is typically between one year and five years.

Revenues in arrangements with multiple deliverables entered into until December 31, 2010 are recognized under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and all other revenue recognition criteria are satisfied.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Starting January 1, 2011 the Company adopted the guidance of ASU 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB ASC Topic 605, Revenue Recognition) ("ASU 2009-13"). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendment eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. As such, the Company prospectively applied these provisions to all revenue arrangements entered into or materially modified after January 1, 2011. For the year ended December 31, 2011, the impact of the adoption of this standard was an increase in revenues in an amount of \$ 5,286.

The Company determines the best estimated selling price ("BESP") in multiple-element arrangements as follows:

VSOE for post-contract customer support is determined based on the price charged when such element is sold separately (renewals). The price may vary in the territories and vertical markets in which the Company conducts business. Price is determined by using a consistent percentage of the Company's product price lists, in the same territories and markets.

For the product, the Company determines the BESP based on management estimated selling price by considering several external and internal factors including, but not limited to, pricing practices including discounting, margin objectives, and competition. The determination of estimated selling price ("ESP") is made through consultation with and approval of management, taking into consideration the pricing model and go-to-market strategy.

The Company records a provision for estimated sale returns and stock rotation granted to customers on products in the same period the related revenues are recorded in accordance with ASC No. 605. These estimates are based on historical sales returns, stock rotations and other known factors. Such provisions amounted to \$ 870 and \$ 1,071 as of December 31, 2011 and 2012, respectively.

Deferred revenues include unearned amounts received under post-contract customer support.

1.Shipping and Handling:

Shipping and handling fees charged to the Company's customers are recognized as product revenue in the period shipped and the related costs for providing these services are recorded as a cost of sale.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Cost of revenues:

Cost of products is comprised of cost of software and hardware production, manuals, packaging, license fees paid to third parties and amortization of acquired technology.

Cost of services is comprised of cost of post sale customer support.

n. Warranty costs:

The Company generally provides a one year warranty for all of its products. A provision is recorded for estimated warranty costs at the time revenues are recognized based on the Company's experience. Warranty expenses for the years ended December 31, 2010, 2011 and 2012 were immaterial.

o. Research and development expenses:

Research and development expenses are charged to the statement of income, as incurred.

p. Grants:

Starting 2012 the Company received non-royalty-bearing grants from the Government of Israel for approved research and development projects. These grants are recognized at the time the Company is entitled to such grants on the basis of the costs incurred as provided by the relevant agreement and included as a deduction from research and development expenses.

Research and development grants deducted from research and development expenses amounted to \$ 264 in 2012.

q. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC No. 718, "Compensation-Stock Compensation". ASC No. 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statement of income.

The Company recognizes compensation expenses for the value of its awards based on the accelerated attribution method over the requisite service period of each of the awards, net of estimated forfeitures. ASC No. 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.





## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

ASC No. 718 requires the cash flows resulting from the tax deductions in excess of the compensation costs recognized for those stock options to be classified as financing cash flows.

The Company selected the Black-Scholes-Merton option pricing model to account for the fair value of its stock-options awards with only service conditions. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over an historical period equivalent to the option's expected term. The expected option term represents the period of time that options granted are expected to be outstanding. Expected term of options granted is based upon historical experience. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value of the Company's stock options granted to employees, consultants and directors for the years ended December 31, 2010, 2011 and 2012 was estimated using the following weighted average assumptions:

Employees stock option plan:

|  | 2010 |   | Year ended<br>December 31,<br>2011 |   | 2012 |   |
|--|------|---|------------------------------------|---|------|---|
| Risk free interest rate                                      | 1.23 | % | 0.99                               | % | 0.46 | % |
| Dividend yields  | 0    | % | 0                                  | % | 0    | % |
| Expected volatility  | 38   | % | 47                                 | % | 47   | % |
| Weighted average expected term from grant date<br>(in years) | 3.44 |   | 3.79                               |   | 3.67 |   |

Employees stock purchase plan:

|   | Year ended<br>December 31,<br>2010 |   |
|---|------------------------------------|---|
| Risk free interest rate                                   | 0.29                               | % |
| Dividend yields   | 0                                  | % |
| Expected volatility                                       | 36                                 | % |
| Weighted average expected term from grant date (in years) | 0.75                               |   |



RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

r. Income taxes:

The Company accounts for income taxes in accordance with ASC No. 740, "Income Taxes". This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that a portion or all of the deferred tax assets will not be realized.

Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences if not related to an asset or liability for financial reporting.

ASC 740 contains a two-step approach to recognizing and measuring a liability for uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company accrues interest related to unrecognized tax benefits in its taxes on income.

s. Concentrations of credit risks:

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

The majority of the Company's and its subsidiaries' cash and cash equivalents and bank deposits are invested in major banks in Israel and the U.S. Deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Generally, these cash equivalents may be redeemed upon demand and, therefore management believes that it bears a lower risk.

The Company's marketable securities include investments in foreign banks and government debentures and corporate debentures. The Company's investment policy limits the amount the Company may invest in each issuer, thereby reducing credit risk concentration.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The trade receivables of the Company and its subsidiaries are mainly derived from sales to customers located primarily in the United States, Europe, the Middle East, Africa and Asia Pacific. The Company performs ongoing credit evaluations of its customers. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. In certain circumstances, the Company may require from its customers letters of credit, other collateral or additional guarantees. Bad debt expenses for the years ended December 31, 2010, 2011 and 2012 were \$ 270, \$ 0 and \$ 0, respectively. Total write offs during 2010, 2011 and 2012 amounted to \$ 0, \$ 200 and \$ 7, respectively.

t. Severance pay:

The Company's liability for severance pay for periods prior to April 1, 2007 is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. The Company recorded as expenses the increase in the severance liability, net of earnings (losses) from the related investment fund. Employees were entitled to one month's salary for each year of employment, or a portion thereof. Until April 1, 2007, the Company's liability was partially funded by monthly payments deposited with insurers; any unfunded amounts would be paid from operating funds and are covered by a provision established by the Company.

The carrying value of the deposited funds for the Company's employees' severance pay for employment periods prior to April 1, 2007 include profits and losses accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements.

Effective April 1, 2007, the Company's agreements with employees in Israel are in accordance with section 14 of the Severance Pay Law - 1963 which provide that the Company's contributions to severance pay fund shall cover its entire severance obligation with respect to period of employment subsequent to April 1, 2007. Upon termination, the release of the contributed amounts from the fund to the employee shall relieve the Company from any further severance obligation and no additional payments shall be made by the Company to the employee. As a result, the related obligation and amounts deposited on behalf of such obligation are not stated on the balance sheet, as the Company is legally released from severance obligation to employees once the amounts have been deposited, and the Company has no further legal ownership on the amounts deposited. Consequently, effective from April 1, 2007, the Company increased its contribution to the deposited funds to cover the full amount of the employees' salaries.

Severance pay expenses for the years ended December 31, 2010, 2011 and 2012 amounted to approximately \$ 1,866, \$ 2,244 and \$ 1,945, respectively. Accrued severance pay is included in other long term liabilities in the Balance sheet.



RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Fair value of financial instruments:

The Company measures its cash equivalents and marketable securities at fair value. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

Level 1 -Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 -Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 -Unobservable inputs which are supported by little or no market activity.

v. Comprehensive income:

The Company accounts for comprehensive income in accordance with ASC No. 220, "Comprehensive Income." This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. The Company determined that its only item of other comprehensive income relate to available for sale marketable securities adjustment.

In May 2011, the FASB issued guidance that changed the requirement for presenting "Comprehensive Income" in the consolidated financial statements. The update requires an entity to present the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Company adopted this new guidance on January 1, 2012 and elected to present the comprehensive income in two separate but consecutive statements.

w. Treasury stock:

The Company repurchases its Ordinary shares on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity. The voting rights attached to treasury stock are revoked.



## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

## x. Basic and diluted net income per share:

Basic net income per share is computed based on the weighted average number of Ordinary shares outstanding during each period. Diluted net income per share is computed based on the weighted average number of Ordinary shares outstanding during each period, plus dilutive potential Ordinary shares considered outstanding during the period, in accordance with ASC No. 260, "Earnings Per Share".

The total number of shares related to outstanding options excluded from the calculation of diluted income per share as they would have been anti dilutive was 482,350, 1,131,800 and 951,100 for the years ended December 31, 2010, 2011 and 2012, respectively.

## y. Reclassifications:

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. An amount of \$6,923 of deferred revenue was reclassified from long term liabilities to short term liabilities. The reclassification had no effect on previously reported net income or shareholders' equity

## NOTE 3:- MARKETABLE SECURITIES

Marketable securities with contractual maturities of less than one year are as follows:

|  | December 31,   |                         |                        |              | December 31,   |                         |                        |              |
|--|----------------|-------------------------|------------------------|--------------|----------------|-------------------------|------------------------|--------------|
|  | 2011           |                         | 2012                   |              | 2011           |                         | 2012                   |              |
|  | Amortized cost | Gross unrealized losses | Gross unrealized gains | Market value | Amortized cost | Gross unrealized losses | Gross unrealized gains | Market Value |
| Foreign banks and government debentures        | \$ 6,162       | \$ (46 )                | \$ 7                   | \$ 6,123     | \$ 8,312       | \$ (4 )                 | \$ 36                  | \$ 8,344     |
| Corporate debentures                           | 4,212          | (4 )                    | 3                      | 4,211        | 5,590          | -                       | 70                     | 5,660        |
| Total available-for-sale marketable securities | \$ 10,374      | \$ (50 )                | \$ 10                  | \$ 10,334    | \$ 13,902      | \$ (4 )                 | \$ 106                 | \$ 14,004    |





## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

Marketable securities with contractual maturities from one to three years are as follows:

|  | December 31, |                  |                  |           | December 31, |                  |                  |           |
|--|--------------|------------------|------------------|-----------|--------------|------------------|------------------|-----------|
|  | 2011         |                  | 2012             |           | 2011         |                  | 2012             |           |
|  | Amortized    | Gross unrealized | Gross unrealized | Market    | Amortized    | Gross unrealized | Gross unrealized | Market    |
|  | cost         | losses           | gains            | value     | cost         | Losses           | gains            | Value     |
| Foreign banks and government debentures        | \$ 34,989    | \$ (645 )        | \$ 33            | \$ 34,377 | \$ 49,673    | \$ (3 )          | \$ 1,233         | \$ 50,903 |
| Corporate debentures                           | 16,720       | (28 )            | 204              | 16,896    | 19,278       | -                | 402              | 19,680    |
| Total available-for-sale marketable securities | \$ 51,709    | \$ (673 )        | \$ 237           | \$ 51,273 | \$ 68,951    | \$ (3 )          | \$ 1,635         | \$ 70,583 |

Marketable securities with contractual maturities of more than three years are as follows:

|  | December 31, |                  |                  |           | December 31, |                  |                  |           |
|--|--------------|------------------|------------------|-----------|--------------|------------------|------------------|-----------|
|  | 2011         |                  | 2012             |           | 2011         |                  | 2012             |           |
|  | Amortized    | Gross unrealized | Gross unrealized | Market    | Amortized    | Gross unrealized | Gross unrealized | Market    |
|  | cost         | losses           | gains            | value     | cost         | Losses           | gains            | Value     |
| Foreign banks and government debentures        | 33,623       | (1,426 )         | 85               | 32,282    | \$ 27,287    | (38 )            | 813              | 28,062    |
| Corporate debentures                           | 18,935       | (129 )           | 283              | 19,089    | 22,207       | (102 )           | 364              | 22,469    |
| Total available-for-sale marketable securities | \$ 52,558    | \$ (1,555 )      | \$ 368           | \$ 51,371 | \$ 49,494    | \$ (140 )        | \$ 1,177         | \$ 50,531 |

All investments with unrealized loss as of December 31, 2012 are with continuous unrealized losses for less than 12 months.

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## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

Investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values as of December 31, 2011 were as follows:

|  | Investments with<br>continuous unrealized<br>losses for less than 12<br>months |                      | December 31, 2011<br>Investments with<br>continuous unrealized<br>losses for 12 months<br>or greater |                      | Total investments with<br>continuous unrealized<br>losses |                      |
|--|--|----------------------|--|----------------------|---|----------------------|
|  | Fair<br>value  | Unrealized<br>losses | Fair<br>value  | unrealized<br>losses | Fair<br>value   | unrealized<br>losses |
| Foreign banks and<br>government<br>debentures        | \$ 49,510  | \$ (1,999 )          | \$ 6,858   | \$ (116 )            | \$ 56,368   | \$ (2,115 )          |
| Corporate debentures                                 | 8,943  | (152 )               | 1,594  | (10 )                | 10,537  | (162 )               |
| Total<br>available-for-sale<br>marketable securities | \$ 58,453  | \$ (2,151 )          | \$ 8,452   | \$ (126 )            | \$ 66,905   | \$ (2,277 )          |

As of December 31, 2011 and 2012, interest receivable amounted to \$ 1,274 and \$ 1,490, respectively, and is included within available for sale marketable securities in the balance sheets.

## NOTE 4:- FAIR VALUE MEASUREMENTS

In accordance with ASC 820, the Company measures its cash equivalents and available for sale marketable securities at fair value on recurring basis. Cash equivalents and marketable securities are classified within Level 1 or Level 2. This is because these assets are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

The Company's financial assets measured at fair value on a recurring basis, including interest receivable components consisted of the following types of instruments as of December 31, 2012 and 2011:

|                     | December 31, 2012<br>Fair value measurements using input type |         |         | Total  |
|---------------------|---|---------|---------|--------|
|                     | Level 1   | Level 2 | Level 3 |        |
| Cash equivalents:   |   |         |         |        |
| Money market funds  | \$ 701  | \$ -    | \$ -    | \$ 701 |
| Available-for-sale: |   |         |         |        |

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|   |        |            |      |            |
|---|--------|------------|------|------------|
|   |        |            |      |            |
| Foreign banks and government debentures | -      | 87,309     | -    | 87,309     |
| Corporate debentures                    | -      | 47,809     | -    | 47,809     |
|   |        |            |      |            |
| Total financial assets                  | \$ 701 | \$ 135,118 | \$ - | \$ 135,819 |

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## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 4:- FAIR VALUE MEASUREMENTS (Cont.)

|   | December 31, 2011                        |            |         |            |
|---|--|------------|---------|------------|
|   | Fair value measurements using input type |            |         |            |
|   | Level 1                                  | Level 2    | Level 3 | Total      |
| Cash equivalents:                       |  |            |         |            |
| Money market funds                      | \$ 1,247                                 | \$ -       | \$ -    | \$ 1,247   |
| Available-for-sale:                     |  |            |         |            |
| Foreign banks and government debentures | -  | 72,783     | -       | 72,783     |
| Corporate debentures                    | -  | 40,195     | -       | 40,195     |
| Total financial assets                  | \$ 1,247                                 | \$ 112,978 | \$ -    | \$ 114,225 |

## NOTE 5:- INVENTORIES

Inventories are comprised of the following:

|                              | December 31, |           |
|------------------------------|--------------|-----------|
|                              | 2011         | 2012      |
| Raw materials and components | \$ 1,502     | \$ 1,725  |
| Work-in-progress             | 1,647        | 1,479     |
| Finished products (*)        | 8,998        | 9,341     |
|                              | \$ 12,147    | \$ 12,545 |

(\*)Includes amounts of \$ 389 and \$ 337, as of December 31, 2012 and 2011, respectively, with respect to inventory delivered to customers but for which revenue criteria have not been met and will be recognized in the future.

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 6:- PROPERTY AND EQUIPMENT, NET

|   | December 31, |           |
|---|--------------|-----------|
|   | 2011         | 2012      |
| Cost:                                       |              |           |
| Computer, peripheral equipment and software | \$ 40,741    | \$ 48,182 |
| Office furniture and equipment              | 3,750        | 4,619     |
| Leasehold improvements                      | 2,282        | 2,494     |
|   | 46,773       | 55,295    |
| Accumulated depreciation:                   |              |           |
| Computer, peripheral equipment and software | 31,842       | 37,333    |
| Office furniture and equipment              | 2,515        | 2,857     |
| Leasehold improvements                      | 1,332        | 1,516     |
|   | 35,689       | 41,706    |
| Property and equipment, net                 | \$ 11,084    | \$ 13,589 |

Depreciation expenses for the years ended December 31, 2010, 2011 and 2012 were \$ 5,069, \$ 6,451 and \$ 6,832, respectively.

During 2011 and 2012 the Company recorded a reduction of \$ 808 and \$ 815, respectively to the cost and accumulated depreciation of fully depreciated equipment no longer in use.

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 7:- INTANGIBLE ASSETS, NET

|  | Weighted<br>average<br>amortization<br>period<br>(years) | December 31, |           |
|--|--|--------------|-----------|
|  |  | 2011         | 2012      |
| Cost:                                  |  |              |           |
| Acquired technology                    | 6  | \$ 12,625    | \$ 12,625 |
| Customers relationships and brand name | 7  | 9,107        | 9,107     |
|  |  | 21,732       | 21,732    |
| Accumulated amortization:              |  |              |           |
| Acquired technology                    |  | 6,945        | 8,814     |
| Customers relationships and brand name |  | 6,624        | 7,790     |
|  |  | 13,569       | 16,604    |
| Intangible assets, net                 |  | \$ 8,163     | \$ 5,128  |

Amortization expenses for the years ended December 31, 2010, 2011 and 2012 were \$ 3,983, \$ 3,848 and \$ 3,035, respectively.

Future estimated amortization expenses for the years ending:

December 31,

|                     |          |
|---------------------|----------|
| 2013                | \$ 2,661 |
| 2014                | 1,237    |
| 2015                | 515      |
| 2016                | 409      |
| 2017 and thereafter | 306      |
| Total               | \$ 5,128 |



## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 8:- OTHER PAYABLES AND ACCRUED EXPENSES

|                            | December 31, |           |
|----------------------------|--------------|-----------|
|                            | 2011         | 2012      |
| Accrued expenses and other | \$ 4,451     | \$ 6,436  |
| Accrued Taxes              | 2,533        | 7,306     |
|                            | \$ 6,984     | \$ 13,742 |

## NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES

## a. Lease commitments:

The facilities of the Company and its subsidiaries are leased under various operating lease agreements, which expire on various dates, the latest of which is on September 30, 2018. Aggregate minimum rental payments under non-cancelable operating leases as of December 31, 2012, are (in the aggregate) and for each succeeding fiscal year below:

|                     |       |
|---------------------|-------|
| 2013                | 2,891 |
| 2014                | 863   |
| 2015                | 172   |
| 2016                | 83    |
| 2017 and thereafter | 151   |
|                     | 4,160 |

Total rent expenses for the years ended December 31, 2010, 2011 and 2012 were \$ 3,556, \$ 3,922 and \$ 4,199, respectively (see also Note 15b).

## b. Litigation:

1. Domestically, following audit of the Company's 2004 and 2005 corporate tax returns, in December 2010, the Israeli Tax Authority issued orders challenging the Company's positions on several matters. The ITA, therefore, demanded the payment of additional taxes in the aggregate amount of NIS 16.1 million (\$4,317 using December 31, 2012 exchange rate) for 2004 and NIS 15.5 million (\$4,156 using December 31, 2012 exchange rate) for 2005 including interest as of the assessment date.

In addition following audit of the Company's 2006 and 2008 corporate tax returns, in January 2012, the Israeli Tax Authority issued orders challenging the Company's positions on several matters. The ITA, therefore, demanded the payment of additional taxes in the aggregate amount of NIS 25.2 million (\$6,757 using December 31, 2012 exchange rate) for 2006 and NIS 8.1 million (\$2,172 using December 31, 2012 exchange rate) for 2008 including interest as of the assessment date.

The Company has appealed the orders relating to the four years mentioned above with the Tel Aviv District court, and these appeals are pending. There can be no assurance that the court will accept the Company's positions on matters raised and, in such an event, the company may record additional tax expenses if these matters are settled for amounts in excess of the current provisions.

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## RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

## NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

2. In November 2011, SNMP Research International, Inc. and SNMP Research, Inc. commenced a lawsuit in the United States Bankruptcy Court for the District of Delaware against Nortel Networks, Inc. (and certain of its affiliates entities), Genband US LLC, GENBAND, Inc., Performance Technologies, Inc., Perftech (PTI) Canada, Avaya, Inc. and Radware, Ltd. The complaint alleges that the Company has infringed certain of SNMP's copyrights, misappropriated certain of SNMP's trade secrets, were unjustly enriched, and converted certain of SNMP's intellectual property. SNMP has asserted that as part of the Company's acquisition of the Layer 4-7 Application Delivery business from Nortel Networks in March 2009, the Company received certain intellectual property of SNMP Research that was embedded in the Layer 4-7 business. The complaint does not specify the amount of damages and requests that such amount be determined at trial. The Company was recently served with the complaint in Israel. The Company advised SNMP Research that the Company diligently investigated whether software received from Nortel included SNMP Software, and based on such investigation no SNMP Software was found. Draft settlement agreements are circulating which impose no liability on the Company. If settlement is not reached and SNMP Research does not dismiss the lawsuit, the Company intends to vigorously defend the litigation which still is in a preliminary stage, and cannot estimate what impact, if any, the litigation may have on the Company's results of operations, financial condition or cash flows.

3. On October 22, 2012, Branch Banking and Trust Co. ("BB&T") filed a third-party complaint in the Eastern District of Texas against Radware Inc. ("Radware") seeking indemnification for patent infringement claims brought by TQP Development LLC ("TQP") against BB&T in the same court. The complaint alleges that BB&T purchased certain products from Nortel Networks Inc. ("Nortel") and Covelight Systems Inc. and that TQP has alleged that BB&T's use of these products infringes certain TQP patents. BB&T further alleges that Radware is the successor in interest to Nortel and Covelight and that Radware has refused to defend and hold BB&T harmless against TQP's allegations in breach of BB&T's agreements and warranties with Nortel and Covelight. On January 14, 2013, Radware filed an answer and counterclaim denying that Radware has any indemnity obligations to BB&T and seeking declaratory judgment as to each of BB&T's asserted causes of action. The Court has yet to schedule a case management conference regarding BB&T's third party complaint.

On March 22, 2013, BB&T agreed to dismiss the complaint voluntarily and enter into a tolling agreement with Radware that would prevent either party from refiling the lawsuit until after the underlying TQP patent infringement claims against BB&T are resolved.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

4. From time to time, the Company is party to other various legal proceedings, claims and litigation that arise in the normal course of business. It is the opinion of management that the ultimate outcome of these matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

NOTE 10:- SHAREHOLDERS' EQUITY

The Company's shares are listed for trade on the NASDAQ National Market under the symbol "RDWR".

a. Rights of shares:

Ordinary shares:

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

b. Treasury stock:

In July 2006, the Company's Board of Directors authorized the repurchase of up to \$ 25,000 in the open market, subject to normal trading restrictions. Through the years 2006-2009, the Company purchased a total of 1,795,957 of its Ordinary shares for total consideration of \$ 18,082. Total consideration for the purchase of these Ordinary shares was recorded as Treasury shares, at cost, as part of shareholders' equity.

In October 2011, the Company's Board of Directors authorized the repurchase of up to an aggregate of \$ 20,000 of the Company's ordinary shares in the open market, subject to normal trading restrictions. The repurchase program expired in October 2012. No shares have been purchased under this program.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 10:- SHAREHOLDERS' EQUITY

c. Dividends:

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

d. Stock Option Plans:

The Company has two stock option plans, the Company's Key Employee Share Incentive Plan (1997) and the Directors and Consultants Option Plan ("the Stock Option Plans"). Under the Stock Option Plans, options may be granted to officers, directors, employees and consultants of the Company or its subsidiaries. The exercise price per share under the Stock Option Plans was generally not less than the market price of an Ordinary share at the date of grant. The options expire between 5.2 years to 6 years from the grant date. The options vest primarily over four years. Each option is exercisable for one Ordinary share. Any options, which are forfeited or not exercised before expiration, become available for future grants.

Pursuant to the Stock Option Plans, the Company reserved for issuance 11,187,318 Ordinary shares. As of December 31, 2012, an aggregate of 445,717 Ordinary shares of the Company were still available for future grants

On February 1, 2010, the Company's Board of Directors adopted an additional addendum to the share option plan allowing the allocation of short term options to grantees who are not residents of Israel or the United States, with a grant price of 90% of the closing market price of the shares on the NASDAQ on the date of grant of a respective option award. As of December 31, 2012, 500,000 ordinary shares have been reserved for option grants under this addendum. As of December 31, 2012, an aggregate of 381,653 Ordinary shares of the Company, under this addendum, were still available for future grants.

Employee Stock Purchase Plan ("ESPP"):

On February 1, 2010 the Company's Board of Directors adopted the 2010 Employee Share Purchase Plan ("ESPP"), which provides for the issuance of a maximum of 1,000,000 ordinary shares. Pursuant to the ESPP, eligible employees (including only Israeli and United States residents) could have up to 10% of their net income withheld, up to certain maximums, to be used to purchase the Company's ordinary shares. The ESPP is implemented with overlapping one year Offering Periods, each one consisting of two purchases, once in every six-month period. The price of each ordinary share purchased under the ESPP is equal to 90% of the closing price for the shares on the respective Offering Date.

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

During 2011 and 2010, employees purchased 68,329 and 59,451, respectively, of Ordinary shares at average prices of \$ 14.75 and \$ 14.18, respectively. During 2012, there was no offering under the ESPP.

As of December 31, 2012, 872,220 Ordinary shares are available for issuance under future ESPP.

In accordance with ASC No. 820, the ESPP is compensatory and as such results in recognition of compensation cost. For the years ended December 31, 2011 and 2010, the Company recognized \$ 50 and \$ 306, respectively, of compensation expense in connection with the ESPP.

A summary of employees, consultants and directors option activity under the Company's Stock Option Plans as of December 31, 2012 is as follows:

|  | Number of<br>options | Weighted-average<br>exercise price | Weighted-<br>average<br>remaining<br>contractual<br>term<br>(in years) | Aggregate<br>intrinsic<br>value |
|--|----------------------|------------------------------------|--|---------------------------------|
| Outstanding at January 1, 2012                   | 4,074,653            | \$ 17.60                           | 3.20   | 51,707                          |
| Granted  | 395,200              | 34.83                              |  |                                 |
| Exercised  | (935,152 )           | 11.38                              |  |                                 |
| Expired  | (13,000 )            | 13.50                              |  |                                 |
| Forfeited  | (363,427 )           | 25.07                              |  |                                 |
| Outstanding at December 31, 2012                 | 3,158,274            | 20.76                              | 2.68   | 40,796                          |
| Exercisable at December 31, 2012                 | 1,402,650            | 14.10                              | 1.91   | 26,588                          |
| Vested and expected to vest at December 31, 2012 | 2,997,841            | 20.23                              | 2.62   | 40,160                          |

The aggregate intrinsic value of options outstanding at December 31, 2012, represents intrinsic value of 2,560,574 outstanding options that are in-the-money as of December 31, 2012. The remaining 597,700 outstanding options are out of the money as of December 31, 2012, and their intrinsic value was considered as zero.

The aggregate intrinsic value of options exercisable at December 31, 2012 represents intrinsic value of 1,328,150 outstanding options that are in-the-money as of December 31, 2012. The remaining 74,500 outstanding options are out of the money as of December 31, 2012, and their intrinsic value was considered as zero.

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## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

The weighted-average grant-date fair value of options granted during the years ended December 31, 2010, 2011 and 2012 was \$ 6.34, \$ 11.33 and \$ 12.32, respectively.

As of December 31, 2012, there was approximately \$ 6,304 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 3.3 years. Total grant-date fair value of vested options for the year ended December 31, 2012 was approximately \$ 7,353.

The options outstanding under the Company's Stock Option Plans as of December 31, 2012 have been separated into ranges of exercise price as follows:

| Ranges of exercise price | Outstanding       |   | Exercisable                     |                   |                                 |
|--------------------------|-------------------|---|---------------------------------|-------------------|---------------------------------|
|                          | Number of options | Weighted average remaining contractual life (years) | Weighted average exercise price | Number of options | Weighted average exercise price |
| \$ 6.15-8.99             | 815,424           | 1.56  | 8.26                            | 532,475           | 8.60                            |
| \$ 10.64-15.61           | 871,825           | 2.00  | 14.84                           | 705,175           | 14.88                           |
| \$ 23.87-24.67           | 519,925           | 3.47  | 24.22                           | 90,500            | 23.98                           |
| \$ 31.21-38.59           | 951,100           | 3.84  | 35.03                           | 74,500            | 33.98                           |
|                          | 3,158,274         |   |                                 | 1,402,650         |                                 |

Stock-based compensation was recorded in the following items

|                            | Year ended December 31, |          |          |
|----------------------------|-------------------------|----------|----------|
|                            | 2010                    | 2011     | 2012     |
| Cost of sales              | \$ 64                   | \$ 66    | \$ 66    |
| Research and development   | 1,247                   | 1,124    | 1,103    |
| Selling and marketing      | 2,393                   | 3,135    | 3,298    |
| General and administrative | 1,789                   | 1,133    | 916      |
| Total Expenses             | \$ 5,493                | \$ 5,458 | \$ 5,383 |



## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 11:- EARNINGS PER SHARE

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

|   | 2010       | Year ended<br>December 31,<br>2011 | 2012       |
|---|------------|------------------------------------|------------|
| Numerator for basic and diluted net earnings per share:     |            |                                    |            |
| Net income  | \$ 9,634   | \$ 21,337                          | \$ 31,757  |
| Weighted average shares outstanding, net of treasury stock: |            |                                    |            |
| Denominator for basic net earnings per share                | 19,557,545 | 20,952,866                         | 21,854,639 |
| Effect of dilutive securities:                              |            |                                    |            |
| Employee stock options                                      | 2,176,093  | 1,935,198                          | 1,439,808  |
| Denominator for diluted net earnings per share              | 21,733,638 | 22,888,064                         | 23,294,447 |
| Basic net earnings per share                                | \$ 0.49    | \$ 1.02                            | \$ 1.45    |
| Diluted net earnings per share                              | \$ 0.44    | \$ 0.93                            | \$ 1.36    |

## NOTE 12:- TAXES ON INCOME

## a. General:

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|  | 2011     | 2012     |
|--|----------|----------|
| Beginning balance                        | \$ 1,027 | \$ 1,669 |
| Additions for prior year tax positions   | (7 )     | 1,216    |
| Additions for current year tax positions | 649      | 2,774    |
| Ending balance                           | \$ 1,669 | \$ 5,659 |

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RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

The Company's Israeli tax returns have been examined for all years prior to fiscal 2004, and the Company is no longer subject to audit for these periods.

As of December 31, 2012, the entire amount of the unrecognized tax benefits could affect the Company's income tax provision and the effective tax rate.

During the years ended December 31, 2012, 2011 and 2010 an amount of \$ 512, \$ (7) and \$ 117, respectively, was added to the unrecognized tax benefits derived from interest and exchange rate differences expenses related to prior years' uncertain tax positions. As of December 31, 2012 and 2011, the Company had accrued interest liability related to uncertain tax positions in the amounts of \$ 959 and \$ 447 respectively, which is included within income tax accrual on the balance sheets.

Exchange rate differences are recorded within financial income, net, while interest is recorded within income tax expense.

The Company's U.S subsidiary files income tax return in the U.S federal jurisdiction. Tax returns have been examined for all years prior to fiscal 2010, and the Company's U.S subsidiary is no longer subject to audit for these periods.

The Company believes that it has adequately provided for any reasonably foreseeable outcome related to tax audits and settlement. The final tax outcome of its tax audits could be different from that which is reflected in the Company's income tax provisions and accruals. Such differences could have a material effect on the Company's income tax provision and net income in the period in which such determination is made.

b. Israeli Taxation:

1. Foreign Exchange Regulations:

Commencing in taxable year 2003, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations. Under the Foreign Exchange Regulations the Israeli company is calculating its tax liability in U.S. Dollars according to certain orders. The tax liability, as calculated in U.S. Dollars is translated into NIS according to the exchange rate as of December 31st of each year.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

2. Tax rates:

Taxable income of the Israeli companies is subject to the Israeli corporate tax at the rate as follows: 2010 - 25%, 2011 - 24%, 2012 – 25%

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

The Company's production facilities in Israel (Tel-Aviv and Jerusalem) have been granted an "Approved Enterprise" status under the above state law. According to the provisions of such Israeli law, the Company has been granted the "Alternative Benefit Track", under which the main benefits are a tax exemption and reduced tax rate. Therefore, the Company's income derived from the Approved Enterprise and allocated to the Tel Aviv facility will be entitled to a tax exemption for a period of two years and to an additional period of five to eight years with reduced tax rates of 10%-25% (based on percentage of foreign ownership). Income allocated to the Jerusalem facility will be exempt from tax for a period of up to 10 years, provided that the Company meets certain criteria. The income derived from the "Approved Enterprise" program shall be allocated between the facilities in Tel-Aviv and Jerusalem based on a mechanism as determined by the Investment Center.

The duration of tax benefits is subject to a limitation of the earlier of 12 years from commencement of production, or 14 years from the approval date. The Company began to utilize such tax benefits in 2004.

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

If retained earning tax-exempt income will be distributed in the future, it would be taxed at the corporate tax rate applicable to such profits with respect to the gross amount as if the Company had not elected the alternative tax benefits (currently between 10% - 25%, based on percentage of foreign ownership at the date of declaration).

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

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

During 2004, the Company's production facilities in Israel (Tel-Aviv and Jerusalem) have been granted an expansion program for its Approved Enterprise status by the Investment Center. The Company applied for an amendment to this expansion program, according to which it requested an enlargement to this expansion program, neutralization of certain assets and an approval that the benefits period from such expansion program will commence in 2006. In 2010, the Investment Center granted an approval for the year 2006.

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

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of the Company's business income from export. In order to be eligible for the tax benefits, the Amendment states that a company must make an investment in the Beneficiary Enterprise exceeding a minimum amount specified in the law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Beneficiary Enterprise ("the Year of Election"). Where a company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Beneficiary Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Beneficiary Enterprise is required to exceed a certain percentage of the company's production assets before the expansion. The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the commencement year, or 12 years from the first day of the year of election. The Company elected 2009 as year of election according to the law prior to the reform mentioned below

In the event of distribution of dividends from the above mentioned tax-exempt income, the amount distributed will be subject to the same reduced corporate tax rate that would have been applied to the Approved Enterprise's and Benefiting Enterprise's income.

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

In addition, as a result of the amendment, tax-exempt income attributed to Benefiting Enterprise, will subject the Company to taxes upon distribution in any manner including complete liquidation.

The Company's board of directors has determined that it will not distribute any amounts of its undistributed tax-exempt income as dividend. The Company intends to reinvest its tax-exempt income and not to distribute such income as a dividend. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Enterprise and Benefiting Enterprise programs as the undistributed tax exempt income is essentially permanent by reinvestment.

Recently, new legislation amending to the Investment Law was adopted. Under this new legislation, a uniform corporate tax rate will apply to all qualifying income of certain Industrial Companies, as opposed to the current law's incentives, which are limited to income from Approved Enterprises during their benefits period. Under the new law, the uniform tax rate will be 10% in areas in Israel designated as Development Zone A and 15% elsewhere in Israel during 2011-2012, 7% and 12.5%, respectively, in 2013-2014, and 6% and 12%, respectively thereafter. The profits of these Industrial Companies will be freely distributable as dividends, subject to a 15% withholding tax (or lower, under an applicable tax treaty).

Under the transition provisions of the new legislation, the Company may decide to irrevocably implement the new law while waiving benefits provided under the current law or to remain subject to the current law. Changing from the current law to the new law is permitted at any time. As of December 31, 2012, the company remained subject to the current law.

Pursuant to a recent amendment to the Investments Law which became effective on November 12, 2012, a company that elects by November 11, 2013 to pay a corporate tax rate as set forth in that amendment (rather than the regular corporate tax rate applicable to approved enterprise income) with respect to undistributed exempt income accumulated by the Company up until December 31, 2011, will be entitled to distribute a dividend from such income without being required to pay additional corporate tax with respect to such dividend. The Company is currently reviewing the new amendment and its implications.

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 12:- TAXES ON INCOME (Cont.)

c. Taxes on income are comprised as follows:

|                 | 2010   | Year ended<br>December 31,<br>2011 | 2012     |
|-----------------|--------|------------------------------------|----------|
| Current taxes   | \$ 884 | \$ 2,648                           | \$ 5,542 |
| Deferred taxes  | (5 )   | (1,358 )                           | (1,584 ) |
|                 | \$ 879 | \$ 1,290                           | \$ 3,958 |
| Domestic        | \$ 86  | \$ 301                             | \$ 3,531 |
| Foreign         | 793    | 989                                | 427      |
|                 | \$ 879 | \$ 1,290                           | \$ 3,958 |
| Domestic taxes: |        |                                    |          |
| Current taxes   | \$86   | \$915                              | \$3,950  |
| Deferred taxes  | -      | (614 )                             | (419 )   |
|                 | \$86   | \$301                              | \$3,531  |
| Foreign taxes:  |        |                                    |          |
| Current taxes   | \$798  | \$1,733                            | \$1,592  |
| Deferred taxes  | (5 )   | (744 )                             | (1,165 ) |
|                 | \$793  | \$989                              | \$427    |
| Taxes on income | \$879  | \$1,290                            | \$3,958  |

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 12:- TAXES ON INCOME (Cont.)

## d. Deferred income taxes:

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

|  | December 31, |           |
|--|--------------|-----------|
|  | 2011         | 2012      |
| Carryforward tax losses                        | \$ 2,275     | \$ 2,573  |
| Temporary differences                          | 2,086        | 1,893     |
| Intangible assets                              | 230          | 344       |
| Deferred tax assets before valuation allowance | 4,591        | 4,810     |
| Valuation allowance                            | (2,593 )     | (1,225 )  |
| Net deferred tax asset                         | 1,998        | 3,585     |
| Intangible assets, including goodwill          | (481 )       | (577 )    |
| Unrealized gains on marketable securities      | (91 )        | (693 )    |
| Deferred tax liability                         | (572 )       | (1,270 )  |
| Net deferred tax assets                        | \$ 1,426     | \$ 2,315  |
| Domestic:                                      |              |           |
| Non-current deferred tax liability, net        | \$ -         | \$ (124 ) |
| Current deferred tax asset, net                | 615          | 466       |
|  | 615          | 342       |
| Foreign:                                       |              |           |
| Non-current deferred tax asset, net            | 811          | 1,070     |
| Current deferred tax asset, net                | -            | 903       |
|  | 811          | 1,973     |
|  | \$ 1,426     | \$ 2,315  |





RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

Non-current deferred tax liability, net is included within other payables and accrued expenses in the balance sheets. Current deferred tax asset, net is included within other current assets and prepaid expenses in the balance sheets. Non-current deferred tax asset, net is included within other assets in the balance sheets.

Deferred taxes are carried directly to equity if the tax relates to equity items.

e. Foreign:

The Company's subsidiaries in the U.S. have provided valuation allowance in respect of deferred tax assets resulting from carry forward of net operating loss. ASC No. 718 prohibits recognition of a deferred tax asset for excess tax benefits due to stock option exercises that have not yet been realized through a reduction in income tax payable. All net operating loss carry forward relate to excess tax deductions from stock options which have not yet been realized. Such unrecognized deferred tax benefits will be accounted for as a credit to additional paid-in-capital, if and when realized. The net change in the valuation allowance primarily relates to stock option benefits and was accounted for as a credit to additional paid-in-capital.

Through December 31, 2012, the U.S. subsidiary had a U.S. federal loss carry forward of approximately \$ 18,500, which can be carried forward and offset against taxable income up to 20 years, expiring between fiscal 2021 and fiscal 2031. An amount of \$ 12,000 of the net operating loss carry-forwards relates to excess tax deductions from stock options.

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

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 12:- TAXES ON INCOME (Cont.)

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

|  | 2010      | Year ended<br>December 31, |  | 2011      | 2012 |                 |
|--|-----------|----------------------------|--|-----------|------|-----------------|
| Income before taxes, as reported in the consolidated statements of income  | \$ 10,513 |                            |  | \$ 22,627 |      | \$ 35,715       |
| Statutory tax rate   | 25        | %                          |  | 24        | %    | 25              |
| Theoretical tax expense on the above amount at the Israeli statutory tax rate                                      | \$ 2,628  |                            |  | \$ 5,430  |      | \$ 8,929        |
| Tax adjustment in respect of different tax rate of foreign subsidiary  | 49        |                            |  | 365       |      | (194 )          |
| Non-deductible expenses and other permanent differences  | 38        |                            |  | 858       |      | 818             |
| Deferred taxes on losses for which valuation allowance was provided, net   | (3,292 )  |                            |  | (3,512 )  |      | -               |
| Utilization of tax losses and deferred taxes for which valuation allowance was provided, net                       | -         |                            |  | (5,401 )  |      | (1,368 )        |
| Stock compensation relating to stock options per ASC No. 718   | 1,373     |                            |  | 1,310     |      | 1,362           |
| Income taxes in respect of prior years   | 86        |                            |  | 63        |      | -               |
| Benefiting enterprise benefits (*)   | -         |                            |  | 2,177     |      | (6,088 )        |
| Other  | (3 )      |                            |  | -         |      | 499             |
| Actual tax expense   | \$ 879    |                            |  | \$ 1,290  |      | \$ 3,958        |
| (*) Basic earnings per share amounts of the benefit resulting from the "Approved and Privileged Enterprise" status |           |                            |  |           |      |                 |
|  |           |                            |  | \$-       |      | \$(0.1 ) \$0.28 |
| Diluted earnings per share amounts of the benefit resulting from the "Approved and Privileged Enterprise" status   |           |                            |  |           |      |                 |
|  |           |                            |  | \$-       |      | \$-             |
|  |           |                            |  |           |      | \$0.27          |

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 12:- TAXES ON INCOME (Cont.)

g. Income before income taxes is comprised as follows:

|                            | 2010      | Year ended<br>December 31,<br>2011 | 2012      |
|----------------------------|-----------|------------------------------------|-----------|
| Domestic                   | \$ 8,356  | \$ 18,062                          | \$ 32,935 |
| Foreign                    | 2,157     | 4,565                              | 2,780     |
| Income before income taxes | \$ 10,513 | \$ 22,627                          | \$ 35,715 |

## NOTE 13:- GEOGRAPHIC INFORMATION

Summary information about geographic areas:

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

The following table presents total revenues for the years ended December 31, 2010, 2011 and 2012 and long-lived assets as of December 31, 2011 and 2012:

|  | 2010       | Year ended<br>December 31,<br>2011 | 2012       |
|--|------------|------------------------------------|------------|
| Revenues from sales to customers located at: |            |                                    |            |
| The United States                            | \$ 28,497  | \$ 33,932                          | \$ 41,637  |
| America - other                              | 11,995     | 9,763                              | 16,560     |
| EMEA *)                                      | 44,231     | 57,648                             | 57,135     |
| China  | 14,180     | 18,497                             | 19,871     |
| Asia Pacific - other                         | 45,216     | 47,180                             | 53,968     |
|  | \$ 144,119 | \$ 167,020                         | \$ 189,171 |

\*) Europe, the Middle East and Africa.

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 13:- GEOGRAPHIC INFORMATION (Cont.)

|  | December 31, |           |
|--|--------------|-----------|
|  | 2011         | 2012      |
| Long-lived assets, by geographic region: |              |           |
| America (principally the United States)  | \$ 1,040     | \$ 1,010  |
| Israel                                   | 7,617        | 10,552    |
| EMEA - other                             | 777          | 666       |
| Asia Pacific                             | 1,650        | 1,361     |
|  | \$ 11,084    | \$ 13,589 |

## NOTE 14:- SELECTED STATEMENTS OF INCOME DATA

Financial income, net:

|   | Year ended<br>December 31, |          |          |
|---|----------------------------|----------|----------|
|   | 2010                       | 2011     | 2012     |
| Financial income:   |                            |          |          |
| Interest on bank deposits   | \$ 786                     | \$ 1,185 | \$ 2,476 |
| Amortization of premiums, accretion of discounts and<br>interest on marketable debt securities, net | 2,455                      | 3,191    | 2,918    |
|   | 3,241                      | 4,376    | 5,394    |
| Financial expenses:   |                            |          |          |
| Bank charges  | (186 )                     | (163 )   | (219 )   |
| Foreign currency translation differences, net   | (998 )                     | (13 )    | (383 )   |
|   | \$ 2,057                   | \$ 4,200 | \$ 4,792 |

## RADWARE LTD. AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 15:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

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

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

|                   |    | December 31,<br>2011 | 2012     |
|-------------------|----|----------------------|----------|
| Trade receivables | \$ | 1,865                | \$ 1,488 |
| Trade payables    | \$ | 389                  | \$ 1,618 |

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

|  |    | 2010  | Year ended<br>December 31,<br>2011 | 2012     |
|--|----|-------|------------------------------------|----------|
| Revenues (1)   | \$ | 3,203 | \$ 6,211                           | \$ 4,232 |
| Operating expenses, net - primarily lease,<br>sub-contractors and communications (2) | \$ | 2,711 | \$ 3,094                           | \$ 3,809 |
| Purchase of property and equipment   | \$ | 1,841 | \$ 1,078                           | \$ 2,536 |

- (1) Distribution the Company's products on a non-exclusive basis.

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

RADWARE LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 16:- SUBSEQUENT EVENTS

In February 2013, the Company acquired all of the outstanding shares of Strangeloop Networks Inc. (“Strangeloop”), a leader in the Web performance acceleration domain. The total consideration of the acquisition was \$ 8,400. An additional cash consideration of \$ 6,000 (“earn-out”) is to be payable contingent upon meeting technological milestone and upon reaching sales performance targets.

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