Allot Communications Ltd.
Form 20-F
March 21, 2013

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

FORM 20-F

(Mark One)

o	REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
x	REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
o	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………………………………

For the transition period from ______ to ______

Commission File Number 001-33129

ALLOT COMMUNICATIONS LTD.
(Exact Name of Registrant as specified in its charter)

ISRAEL
(Jurisdiction of incorporation or organization)

22 Hanagar Street
Neve Ne'eman Industrial Zone B
Hod-Hasharon 4501317
Israel

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value NIS 0.10 per share	Nasdaq Global Select Market

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

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

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2012: 32,547,151 ordinary shares, NIS 0.10 par value per share

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

Yes o No x

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 o No x

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 x No o

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 (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

U.S. GAAP x	International Financial Reporting Standards as issued by the International Accounting Standards Board o	Other o

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 o Item 18 o

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 o No x

PRELIMINARY NOTES

Terms

As used herein, and unless the context suggests otherwise, the terms “Allot,” “Company,” “we,” “us” or “ours” refer to Al
Communications Ltd.

Forward-Looking Statements

In addition to historical facts, this annual report on Form 20-F contains forward-looking statements within the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These statements include but are not limited to:

- statements regarding projections of capital expenditures;
- statements regarding competitive pressures;
- statements regarding expected revenue growth;
- statements regarding the expected growth demand for video caching and optimization;
- statements regarding trends in mobile networks, including the development of a digital lifestyle, over-the-top applications, the need to manage mobile network traffic and cloud computing, among others;
- statements regarding our ability to develop technologies to meet our customer demands and expand our product and service offerings;
- statements regarding the acceptance and growth of our value-added services by our customers;
- statements regarding the expected growth in the use of particular broadband applications;
- statements as to our ability to meet anticipated cash needs based on our current business plan;
- statements as to the impact of the rate of inflation and the political and security situation on our business;
- statements regarding the price and market liquidity of our ordinary shares;
- statements as to our ability to retain our current suppliers and subcontractors; and
- statements regarding our future performance, sales, gross margins, expenses (including stock-based compensation expenses) and cost of revenues.

These statements may be found in the sections of this annual report on Form 20-F entitled “ITEM 3: Key Information—Risk Factors,” “ITEM 4: Information on Allot,” “ITEM 5: Operating and Financial Review and Prospects,” “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investmen Company Considerations” and elsewhere in this annual report, including the section of this annual report entitled “ITEM 4: Information on Allot—Business Overview—Overview” and “ITEM 4: Information on Allot—Business Overview—Indu Background,” which contain information obtained from independent industry sources. Actual results could differ

materially from those anticipated in these forward-looking statements due to various factors, including all the risks discussed in “ITEM 3: Key Information—Risk Factors” and elsewhere in this annual report.

In addition, statements that use the terms “may,” “believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate” “predict,” “po similar expressions are intended to identify forward-looking statements. All forward-looking statements in this annual report reflect our current views about future events and are based on assumptions and are subject to risks and uncertainties that could cause our actual results to differ materially from future results expressed or implied by the forward-looking statements. Many of these factors are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. Unless we are required to do so under U.S. federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

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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

You should read the following selected consolidated financial data in conjunction with “ITEM 5: Operating and Financial Review and Prospects” and our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. The consolidated statements of operations data for the years ended December 31, 2010, 2011 and 2012 the consolidated balance sheet data as of December 31, 2011 and 2012 are derived from our audited consolidated financial statements included in “ITEM 18: Financial Statements,” which have been prepared in accordance with generally accepted accounting principles in the United States. The consolidated statements of operations for the years ended December 31, 2008 and 2009 and the consolidated balance sheet data as of December 31, 2008, 2009 and 2010 have been derived from our audited consolidated financial statements which are not included in this annual report.

	Year ended December 31,				
	2008	2009	2010	2011	2012
	(in thousands of U.S. dollars, except per share and share data)				
Consolidated Statements of Operations:					
Revenues:					
Products	$27,121	$29,641	$40,852	$56,810	$77,127
Services	9,980	12,110	16,120	20,943	27,625
Total revenues	37,101	41,751	56,972	77,753	104,752
Cost of revenues(1):					
Products	8,198	10,094	14,015	19,540	26,857
Services	1,498	1,741	1,970	2,635	4,180
Expenses related to the settlement of the Office of the Chief Scientist grants(2)	-	-	-	-	15,886
Total cost of revenues	9,696	11,835	15,985	22,175	46,923
Gross profit	27,405	29,916	40,987	55,578	57,829
Operating expenses:					
Research and development, gross	14,635	11,705	14,038	16,896	24,915
Less royalty-bearing grant participation	2,671	2,440	2,774	3,674	2,855
Research and development, net(1)	11,964	9,265	11,264	13,222	22,060
Sales and marketing(1)	19,781	20,408	22,021	26,543	34,127
General and administrative(1)	6,174	5,541	5,473	7,474	10,664
In process research and development	244	-	-	-	-
Total operating expenses	38,163	35,214	38,758	47,239	66,851
Operating income (loss)	(10,758)	(5,298)	2,229	8,339	(9,022)
Financing income (expenses), net	(5,517)	(2,311)	(7,907)	415	1,358

Income (loss) before income tax expenses (benefit)	(16,275)	(7,609)	(5,678)	8,754	(7,664)
Income tax expenses (benefit)	220	63	84	(55)	(926)
Net income (loss)	$(16,495)	$(7,672)	$(5,762)	$8,809	$(6,738)
Basic net earnings (loss) per share	$(0.75)	$(0.35)	$(0.25)	$0.35	$(0.21)
Diluted net earnings (loss) per share	$(0.75)	$(0.35)	$(0.25)	$0.33	$(0.21)
Weighted average number of shares used in computing basic net earnings (loss) per share	22,054,211	22,185,702	22,831,014	25,047,771	31,959,921
Weighted average number of shares used in computing diluted net earnings (loss) per share	22,054,211	22,185,702	22,831,014	27,071,872	31,959,921

(1) Includes stock-based compensation expense related to options granted to employees and others as follows:

	Year ended December 31,				
	2008	2009	2010	2011	2012
	(in thousands of U.S. dollars)				
Cost of revenues	$50	$104	$95	$103	$222
Research and development expenses, net	321	357	352	442	1,186
Sales and marketing expenses	465	775	851	1,001	2,060
General and administrative expenses	866	1,062	692	710	1,349
Total	$1,702	$2,298	$1,990	$2,256	$4,817

(2) Represents the full balance of the contingent liability related to grants received, which will be paid in 2013.

	At December 31,				
	2008	2009	2010	2011	2012
	(in thousands of U.S. dollars)				
Consolidated balance sheet data:					
Cash and cash equivalents	$40,029	$36,470	$42,858	$116,682	$50,026
Short-term deposits and restricted deposits	2,121	2,324	1,060	25,138	78,188
Marketable securities	15,319	14,490	15,531	17,580	14,841
Working capital	40,688	38,179	59,841	158,937	131,598
Total assets	82,851	82,943	95,187	197,058	221,791
Total liabilities	19,672	22,531	30,199	34,489	52,670
Accumulated deficit	(63,703)	(63,694)	(69,456)	(60,647)	(67,385)
Share capital	482	492	527	720	761
Total shareholders' equity	63,179	60,412	64,988	162,569	169,121

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Investing in our ordinary shares involves a high degree of risk. You should consider carefully the risks described below, together with the financial and other information contained in this annual report, before deciding to invest in our ordinary shares. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our ordinary shares would likely decline and you might lose all or part of your investment. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Risks Relating to Our Business

We have a history of losses and may not be able to achieve or maintain profitability in the future.

In 2012, we had a net loss of $6.7million. We have had a history of net losses in all prior fiscal years, other than in 2006 and 2011. Our net losses in 2012 were a result of expenses related to the settlement of approximately $15.9 million in grants from Office of the Chief Scientist of the Ministry of Industry, Trade and Labor, or the Office of the Chief Scientist. Our net losses in 2010 were caused or exacerbated by losses resulting from our realized losses and impairment charges related to auction-rate securities, which we have subsequently sold. We can provide no assurance that we will be able to achieve or maintain profitability, and we may incur losses in the future if we do not generate sufficient revenues.

We may be unable to compete effectively with other companies in our market who offer, or may in the future offer, competing technologies.

We compete in a rapidly evolving and highly competitive sector of the networking technology market, with large incumbent companies having significant market share and established relationships with service providers. We face significant competition from router and switch infrastructure companies, such as Cisco Systems, Inc., Telefonaktiebolager LM Erricson and Huawei Technologies Co., Ltd., which integrate functionalities into their platforms addressing some of the problems that our products address. Our competitors have also identified the potential market opportunity offered by the largest service providers, referred to as Tier 1 operators, and we therefore face intense competition in this portion of our market. Our principal competitors in the field of standalone intelligent policy enforcement and traffic management products enabled by DPI technology are Sandvine Inc. and Procera Networks, Inc. We also face competition from companies that offer partial or alternative solutions addressing limited aspects of the challenges facing broadband providers, such as network monitoring or security.

Our competitors may announce new products, services or enhancements that better meet the needs of customers or changing industry requirements, or may offer alternative methods to achieve customer objectives. One of our direct competitors, Cisco Systems, is substantially larger than we are and has significantly greater financial, sales and marketing, technical, manufacturing and other resources. As the mobile DPI market has grown, new competitors have entered and may continue to enter the market. The entry of new competitors into our market (for example F5 Networks) and acquisitions of our existing competitors by companies with significant resources and established relationships with our potential customers could result in increased competition and harm to our business. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, financial condition or result of operations.

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We depend on one or more significant customers and the loss of any such significant customer could harm our results of operations.

The loss of any significant customer or a significant decrease in business from any such customer could harm our results of operations and financial condition. In addition, revenues from individual customers may fluctuate from time to time based on the timing and the terms under which further orders are received and the duration of the delivery and implementation of such orders. We derived 30%, 15% and 14% of our total revenues in 2010, 2011 and 2012, respectively, from one global Tier 1 mobile operator group.

Industry consolidation may lead to increased competition and may harm our operating results.

Our market may be subject to industry consolidation, as companies attempt to maintain or strengthen their positions in an evolving industry, are unable to continue their operations or are acquired. For example, some of our current and potential competitors have made, or have been reported as considering making, acquisitions or have announced new strategic alliances designed to position them with the ability to provide many of the same services that we provide, to both the service provider and enterprise markets. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our financial condition or results of operations.

Demand for our products may be impacted by government regulation of the telecommunications industry.

Service providers are subject to government regulation in a number of jurisdictions in which we sell our products. There are several proposals in the United States, Europe and elsewhere for regulating service providers' ability to prioritize applications in their networks. Advocates for regulating this industry claim that collecting premium fees from certain "preferred" applications would distort the market for Internet applications in favor of larger and better-funded content providers. They also claim that this would impact end-users who already purchased broadband access only to experience response times that differ based on content provider. Opponents believe that content providers who support bandwidth-intensive applications should be required to pay service providers a premium in order to support further network investments. In August 2008, the United States Federal Communications Commission (the "FCC") issued a ruling prohibiting Comcast, the second-largest broadband provider in the United States, from delaying certain peer-to-peer traffic on its network. Comcast filed an appeal of the ruling in September 2008. In April 2010, a federal appeals court ruled that under current law the FCC had limited power over Web traffic. In December 2010, the FCC adopted rules which would give it regulatory power over Internet service providers in order to prevent them from blocking or unreasonably discriminating against Web content, services or applications. In 2011, Verizon and other broadband companies challenged the FCC's regulations in the United States Court of Appeals for the District of Columbia Circuit, and the case is pending appeal. It is difficult to predict when the Court will issue its decision and the impact the decision will have on our business. Demand from service providers for the traffic management and subscriber management features of our products could be adversely affected if regulations prohibit or limit service providers from managing traffic on their networks. A decrease in demand for these features could adversely impact sales of our products and could have a material adverse effect on our business, financial condition or result of operations.

Demand for our value-added services, such as video caching and optimization and parental control, may be lower than anticipated.

Our value-added services offer customers additional tools to increase the efficiency of their networks or help them derive additional revenues from their end customers. With our acquisition of Ortiva Wireless Inc. (“Ortiva”) and Oversi Networks Ltd. (“Oversi”) in 2012, we enhanced our value-added services by introducing video caching services and optimization services, among other value-added services. The industry and market for such services is still developing. We cannot provide any assurance that demand for such services will continue or grow, or that we will be able to generate revenues from such sales at the levels we anticipate or at all. Any inability to sell or maintain our value-added services may lead to commercial disputes with our customers and to lengthy implementation processes and increased spending on technical solutions, all of which may negatively impact our results of operations.

Our revenues and business will be harmed if we do not keep pace with changes in broadband applications and with advances in technology, including through significant investment.

We will need to invest heavily in the continued development of our technology in order to keep pace with rapid changes in applications and increased broadband network speeds and with our competitors’ efforts to advance their technology. Our ability to develop and deliver effective product offerings depends on many factors, including identifying our customers’ needs, technical implementation of new services and integration of our value-added services with our customers’ existing network infrastructure. While we will continue to introduce innovative value-added services, we cannot provide any assurance that any new products we introduce will achieve the same degree of success that we have with our existing products. Designers of broadband applications that our products identify and manage are using increasingly sophisticated methods to avoid detection and management by network operators. Even if our products successfully identify a particular application, it is sometimes necessary to distinguish between different types of traffic belonging to a single application. Accordingly, we face significant challenges in ensuring that we identify new applications and new versions of current applications as they are introduced without impacting network performance, especially as networks become faster. This challenge is increased as we seek to expand sales of our products in new geographic territories because the applications vary from country to country and region to region. Our business and revenues will be adversely affected if we fail to address our customers’ needs in particular geographic markets or if we fail to develop enhancements to our products in order to keep pace with advances in technology.

The network equipment market is subject to rapid technological progress and to compete, we need to achieve widespread market acceptance.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. To compete, we need to achieve widespread market acceptance. Developments in routers and routing software could also significantly reduce demand for and sales of our products and could cause our products to become obsolete, which may result in inventory write downs. Alternative technologies could achieve widespread market acceptance and displace the technology on which we have based our product architecture. We can give no assurance that our technological approach will achieve broad market acceptance or that other technology or devices will not supplant our technology and products.

We need to increase the functionality of our products and offer additional features and value-added services in order to maintain or increase our profitability.

The market in which we operate is highly competitive and unless we continue to enhance the functionality of our products and add additional features, our competitiveness may be harmed and the average sale prices for our products may decrease. Decreases in sale prices generally result from the introduction by competitors of competing products and from the commoditization and increasing popularity of DPI technology. To counter this trend, we endeavor to

enhance our products by offering higher system speeds, additional features and value-added services such as additional security, video functions, support for additional applications and enhanced reporting tools. We may also need to reduce our per unit manufacturing costs at a rate equal to or greater than the rate at which selling prices decline. If we are unable to reduce costs or offer increased functionally and features, our profitability may be adversely affected.

Sales of our products to large service providers can involve a lengthy sales cycle, which may impact the timing of our revenues and result in us expending significant resources without making any sales.

Our sales cycles to large service providers, including carriers, mobile operators and cable operators, are generally lengthy because these end-customers consider our products to be capital equipment and undertake significant testing to assess the performance of our products within their networks. Furthermore, many of our product and service arrangements with our customers provide that the final acceptance of a product or service may be specified by the customer. In such instances, we do not recognize the revenue until all acceptance criteria have been met. As a result, we often invest significant time from initial contact with a large service provider until it decides to incorporate our products in its network, and we may not be able to recognize the revenue from a customer until all acceptance criteria have been satisfied. We may also expend significant resources in attempting to persuade large service providers to incorporate our products into their networks without success. Even after deciding to purchase our products, the initial network deployment of our products by a large service provider may last up to one year. We have also experienced longer sales cycles as a result of the global economic downturn and uncertainty, particularly in Europe. If a competitor succeeds in convincing a large service provider to adopt that competitor's product, it may be difficult for us to displace the competitor because of the cost, time, effort and perceived risk to network stability involved in changing solutions. As a result, we may incur significant expenses without generating any sales, which could adversely affect our profitability.

The complexity and scope of the solutions and services we provide to larger service providers is increasing. Larger projects entail greater operational risk and an increased chance of failure.

The complexity and scope of the solutions and services we provide to larger service providers is increasing. The larger and more complex such projects are, the greater the operational risks associated with them. These risks include failure to fully integrate our products into the service provider's network or with third-party products, our dependence on subcontractors and partners and on effective cooperation with third-party vendors for the successful and timely completion of such projects. If we encounter any of these risks, we may incur higher costs in order to complete the project and may be subject to contractual penalties resulting in lower profitability. In addition, the project may demand more of our management's time than was originally planned, and our reputation may be adversely impacted.

We depend on third parties to market, sell, install and provide initial technical support for our products for a material portion of our business.

We depend on third-party channel partners, such as distributors, resellers, OEMs and system integrators, to market and sell a material portion of our products to end-customers. In 2012, approximately one-third of our revenues were derived from channel partners. Our channel partners are also responsible for installing our products and providing initial customer support for them. As a result, we depend on the ability of our channel partners to successfully market and sell our products to these end-customers. We also depend on our ability to maintain our relationships with existing channel partners and to develop relationships with new channel partners in key markets. We cannot assure you that our channel partners will market our products effectively, receive and fulfill customer orders for our products on a timely basis or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. In addition, any failure by our channel partners to provide adequate initial support to end-customers could result in customer dissatisfaction with us or our products, which could result in a loss of customers, harm our reputation and delay or limit market acceptance of our products. Our products are complex and it takes time for a new channel partner to gain experience in the operation and installation of these products. Therefore, it may take a period of time before a new channel partner can successfully market, sell and support our products if an existing channel partner ceases to sell our products. Additionally, our agreements with channel partners are generally not exclusive and our channel partners may market and sell products that compete with our products. Our agreements with our distributors and resellers are usually for an initial one-year term and following the expiration of this term, can be

terminated by either party. We can give no assurance that these agreements will remain in effect and any termination of one or more of the agreements may adversely affect our profitability and results of operations.

We are subject to certain regulatory regimes that may affect the way that we conduct business internationally, and our failure to comply with applicable laws and regulations could adversely affect our reputation and result in penalties and increased costs.

We are subject to a complex system of laws and regulations related to international trade, including economic sanctions and export control laws and regulations. It is our policy not to make direct or indirect prohibited sales of our products, including into countries sanctioned under laws to which we are subject, and to contractually limit the territories into which our channel partners may sell our products. Nevertheless, we recently learned that one of our channel partners had sold certain of our products (designed for the enterprise market) outside of its contractually designated territory, including into a sanctioned country, and we subsequently determined that our contract management protocol for authorizing channel partner sales was not adequately followed in that instance.

We are also subject to the U.S. Foreign Corrupt Practices Act, or FCPA, and may be subject to similar worldwide anti-bribery laws that generally prohibit companies and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. Some of the countries in which we operate have experienced governmental corruption to some degree and, in certain circumstances, strict compliance with anti-bribery laws may conflict with local customs and practices.

Despite our compliance and training programs, we cannot be certain that our procedures will be sufficient to ensure consistent compliance with all applicable international trade and anti-corruption laws, or that our employees or channel partners will strictly follow all policies and requirements to which we subject them. Any alleged or actual violations of these laws may subject us to government scrutiny, investigation, debarment, and civil and criminal penalties, which may have an adverse effect on our results of operations, financial condition and reputation.

We are dependent on our traffic management systems and network management application suites for the substantial majority of our revenues.

In the past three years, we increased sales of our Service Gateway platforms and our network management application suite. However, sales of our NetEnforcer traffic management system and NetXplorer network management system continued to account for a significant portion of our revenues in 2011 and 2012. While we currently expect that these systems will continue to account for a considerable portion of our revenues in the immediate future, the growth rate of sales from the these systems has declined from 37% in 2011 to 29% in 2012. If we are unable to increase these sales our business will suffer. In addition, service providers may choose embedded or integrated solutions using routers and switches from larger networking vendors over a standalone solutions we offer. Any factor adversely affecting our ability to sell, or the pricing of or demand for, our NetEnforcer traffic management system and NetXplorer network management system would severely harm our ability to generate revenues and could have a material adverse effect on our business.

We integrate various third-party solutions into our products and may integrate or offer additional third-party solutions in the future. If we lose the right to use such solutions, our sales could be disrupted and we would have to spend additional capital to replace such components.

We integrate various third-party solutions into our products and may integrate or offer additional third-party solutions in the future. Sales of our products could be disrupted if such third-party solutions were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to spend additional capital to either redesign our products to function with alternate third-party solutions or develop substitute components ourselves. We might, as a result, be forced to limit the features available in our current or future product offerings, which could have a material adverse effect on our business.

Our products are highly technical and any undetected software or hardware errors in our products could have a material adverse effect on our operating results.

Our products are complex and are incorporated into broadband networks, which are a major source of revenue for service providers and support critical applications for subscribers and enterprises. Due to the highly technical nature of our products and variations among customers' network environments, we may not detect product defects until our products have been fully deployed in our customers' networks. Regardless of whether warranty coverage exists for a product, we may be required to dedicate significant technical resources to repair any defects. If we encounter significant product problems, we could experience, among other things, loss of major customers, cancellation of product orders, increased costs, delay in recognizing revenues and damage to our reputation. We could also face claims for product liability, tort or breach of warranty. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention. In addition, if our business liability insurance is inadequate or future coverage is unavailable on acceptable terms or at all, our financial condition could be harmed.

Demand for our products depends in part on the rate of adoption of bandwidth-intensive broadband applications, such as Internet video and online video gaming applications, and the impact multiple applications may have on network speed.

Our products are used by service providers and enterprises to monitor and manage bandwidth-intensive applications that cause congestion in broadband networks and impact the quality of experience of users. Demand for our products is driven particularly by growth in applications, which are highly sensitive to network delays and therefore require efficient network management, such as Voice over IP (VoIP), Internet video and television and online video gaming applications. If the rapid growth in the adoption of VoIP and in the popularity of Internet video and online video gaming applications does not continue, the demand for our products may be adversely impacted.

We currently depend on a single subcontractor to manufacture and provide hardware warranty support for our Service Gateway platforms, NetEnforcer traffic management systems and Video Optimization platforms. If this subcontractor experiences delays, disruptions, quality control problems or a loss in capacity, it could materially and adversely affect our operating results.

We currently depend on a single subcontractor, Flextronics (Israel) Ltd., a subsidiary of Flextronics, a global electronics manufacturing services company, to manufacture, assemble, test, package and provide hardware warranty support for our Service Gateway platforms, NetEnforcer traffic management systems and Video Optimization platforms. In addition, our agreement with Flextronics (Israel) requires it to procure and store key components for our products at its facilities. If Flextronics (Israel) experiences delays, disruptions or quality control problems in manufacturing our products, or if we fail to effectively manage our relationship with Flextronics (Israel), product shipments may be delayed and our ability to deliver products to customers could be materially and adversely affected. Flextronics (Israel) may terminate our agreement at any time during the term upon 180-days prior notice. We expect

that it would take approximately six months to transition the manufacturing of our products to an alternate manufacturer and our inventory of completed products may not be sufficient for us to continue delivering products to our customers on a timely basis during any such transition period. Therefore, the loss of Flextronics (Israel) could adversely affect our sales and operating results and harm our reputation.

Certain hardware components for our products come from single or limited sources and we could lose sales if these sources fail to satisfy our supply requirements.

We obtain certain hardware components used in our products from single or limited sources. Although these are off-the-shelf items, because our systems have been designed to incorporate these specific components, any change to these components due to an interruption in supply or our inability to obtain such components on a timely basis would require engineering changes to our products before substitute components could be incorporated. Such changes could be costly and result in lost sales particularly to the central processing unit for our Service Gateway platforms, our NetEnforcer AC-6000, AC-1400, AC-3000, AC-500 and the video optimization platforms VDC. The agreements with our suppliers do not contain any minimum supply commitments. If we or our contract manufacturer fail to obtain components in sufficient quantities when required, our business could be harmed. Our suppliers also sell products to our competitors and may enter into exclusive arrangements with our competitors, stop selling their products or components to us at commercially reasonable prices or refuse to sell their products or components to us at any price. Our inability to obtain sufficient quantities of single-source or limited-sourced components or to develop alternative sources for components or products would harm our ability to maintain and expand our business.

We may expand our business or enhance our technology through acquisitions that could result in diversion of resources and extra expenses. This could disrupt our business and adversely affect our financial condition.

Part of our strategy is to selectively pursue partnerships and acquisitions. In 2008, we acquired the business of Esphion, a developer of video optimization and protection solutions for telecommunications operators and internet service providers, which increased the scope of our product offerings. In 2012, we acquired Ortiva, a developer of solutions for mobile and Internet networks, and Oversi, a developer of products and systems for caching Internet content. The negotiation of acquisitions, investments or joint ventures, as well as the integration of acquired or jointly developed businesses or technologies, could divert our management's time and resources. As of the end of 2012, we consolidated the operations of Ortiva and Oversi with ours, and they no longer operate on a standalone basis. Acquired businesses, technologies or joint ventures may not be successfully integrated with our products and operations and we may not realize the intended benefits of these acquisitions. We may also incur future losses from any acquisition, investment or joint venture. In addition, acquisitions could result in:

- substantial cash expenditures;
- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- a decrease in our profit margins; and
- amortization of intangibles and potential impairment of goodwill.

If acquisitions disrupt our operations or result in significant expenditures or liabilities, our business, operating results or financial conditions may suffer.

If we fail to attract and retain skilled employees, we may not be able to timely develop, sell or support our products.

Our success depends, in large part, on the continued contribution of our research and development, sales and marketing and managerial personnel. If our business continues to grow, we will need to hire additional qualified research and development, sales and marketing and managerial personnel to succeed. The process of hiring, training and successfully integrating qualified personnel into our operation is a lengthy and expensive one. The market for

qualified personnel is very competitive because of the limited number of people available with the necessary technical skills, sales skills and understanding of our products and technology. This is particularly true in Israel, where competition for qualified personnel is intense. Our failure to hire and retain qualified personnel could cause our revenues to decline and impair our ability to meet our research and development and sales objectives.

We may not be able to enforce employees' covenants not to compete under the current laws of some jurisdictions in which we operate and therefore may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.

It is our practice to have our employees sign appropriate non-compete agreements when permitted under applicable law. These agreements prohibit our employees who cease working for us from competing directly with us or working for our competitors for a limited period of time. The enforceability of non-compete clauses in certain jurisdictions in which we operate may be limited. Under the current laws of some jurisdictions in which we operate, we may be unable to enforce these agreements and it may thereby be difficult for us to restrict our competitors from gaining the expertise our former employees gained while working for us.

If we are unable to successfully protect the intellectual property embodied in our technology, our business could be harmed significantly.

Know-how relating to networking protocols, building carrier-grade systems and identifying applications is an important aspect of our intellectual property. To protect our know-how, we customarily require our employees, distributors, resellers, software testers and contractors to execute confidentiality agreements or agree to confidentiality undertakings when their relationship with us begins. Typically, our employment contracts also include the following clauses: assignment of intellectual property rights for all inventions developed by employees and non-disclosure of all confidential information. We cannot provide any assurance that the terms of these agreements are being observed and will be observed in the future. Because our product designs and software are stored electronically and thus are highly portable, we attempt to reduce the portability of our designs and software by physically protecting our servers through the use of closed networks, which prevent external access to our servers. We cannot be certain, however, that such protection will adequately deter individuals or groups from wrongfully accessing our technology. Monitoring unauthorized use of intellectual property is difficult and some foreign laws do not protect proprietary rights to the same extent as the laws of the United States. We cannot be certain that the steps we have taken to protect our proprietary information will be sufficient. In addition, to protect our intellectual property, we may become involved in litigation, which could result in substantial expenses, divert the attention of management, cause significant delays, materially disrupt the conduct of our business or adversely affect our revenue, financial condition and results of operations.

As of December 31, 2012, we had a limited patent portfolio. We had six issued U.S. patents and several pending patent applications. While we plan to protect our intellectual property with, among other things, patent protection, there can be no assurance that:

- current or future U.S. or foreign patents applications will be approved;
- our issued patents will protect our intellectual property and not be held invalid or unenforceable if challenged by third-parties;
- we will succeed in protecting our technology adequately in all key jurisdictions in which we or our competitors operate;
- the patents of others will not have an adverse effect on our ability to do business; or
- others will not independently develop similar or competing products or methods or design around any patents that may be issued to us.

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The failure to obtain patents, inability to obtain patents with claims of a scope necessary to cover our technology or the invalidation of our patents may weaken our competitive position and may adversely affect our revenues.

We may be subject to claims of intellectual property infringement by third parties that, regardless of merit, could result in litigation and our business, operating results or financial condition could be materially adversely affected.

There can be no assurance that we will not receive communications from third parties asserting that our products and other intellectual property infringe, or may infringe their proprietary rights. We are not currently subject to any proceedings for infringement of patents or other intellectual property rights and are not aware of any parties that intend to pursue such claims against us. Any such claim, regardless of merit, could result in litigation, which could result in substantial expenses, divert the attention of management, cause significant delays and materially disrupt the conduct of our business. As a consequence of such claims, we could be required to pay substantial damage awards, develop non-infringing technology, enter into royalty-bearing licensing agreements, stop selling our products or re-brand our products. If it appears necessary, we may seek to license intellectual property that we are alleged to infringe. Such licensing agreements may not be available on terms acceptable to us or at all. Litigation is inherently uncertain and any adverse decision could result in a loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from others and otherwise negatively affect our business. In the event of a successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed or similar technology, our business, operating results or financial condition could be materially adversely affected.

We use certain "open source" software tools that may be subject to intellectual property infringement claims, the assertion of which could impair our product development plans, interfere with our ability to support our clients or require us to pay licensing fees.

Certain of our products contain open source code, and we may use more open source code in the future. Open source code is code that is covered by a license agreement that permits the user to liberally copy, modify and distribute the software without cost, provided that users and modifiers abide by certain licensing requirements. The original developers of the open source code provide no warranties on such code. As a result of our use of open source software, we could be subject to suits by parties claiming ownership of what we believe to be open source code, and we may incur expenses in defending claims that we did not abide by the open source code license. If we are not successful in defending against such claims, we may be subject to monetary damages or be required to remove the open source code from our products. Such events could disrupt our operations and the sales of our products, which would negatively impact our revenues and cash flow. In addition, under certain conditions, the use of open source code to create derivative code may obligate us to make the resulting derivative code available to others at no cost. If we are required to publicly disclose the source code for such derivative products or to license our derivative products that use an open source license, our previously proprietary software products would be available to others, including our customers and competitors without charge. We monitor our use of such open source code to avoid subjecting our products to conditions that we do not intend. The use of such open source code, however, may ultimately subject some of our products to unintended conditions so that we are required to take remedial action that may divert resources away from our development efforts.

Unfavorable global economic conditions could have a material adverse effect on our business, financial condition or operating results.

The 2008 and 2009 crisis in the financial and credit markets in the United States, Europe and Asia led to a global economic slowdown that is ongoing, with economies in those territories continuing to show significant weakness and there is continuing economic uncertainty. If the economies of any part of the world remain uncertain or further deteriorate, many enterprises, telecommunication carriers and service providers may significantly reduce or postpone capital investments. This could result in reductions in the sales of our products or services, longer sales cycles, slower

adoption of new technologies and increased price competition. As a result of the most recent downturn in the European economies, we have experienced longer sales cycles than in the past.

We continuously monitor market trends and intend to take such steps as we deem appropriate to adjust our operations. Because a substantial portion of our operating expenses consist of salaries, we may not be able to reduce our operating expenses in line with any reduction in revenues or may elect not to do so for business reasons. We will need to continue to generate increased revenues and manage our costs to maintain profitability. If global economic and market conditions do not improve, or continue to remain uncertain, this may increase our inventories, decrease our revenues, result in additional pressure on the price of our products, prolong payment terms or increase the risk of our incurrence of bad debts. Such circumstances would have a material adverse effect on our results of operations and cash flow from operations.

Our international operations expose us to the risk of fluctuations in currency exchange rates.

Our revenues are generated primarily in U.S. dollars and a major portion of our expenses are denominated in U.S. dollars. As a result, we consider the U.S. dollar to be our functional currency. Other significant portions of our expenses are denominated in shekels and to a lesser extent in Euros and other currencies. Our shekel-denominated expenses consist principally of salaries and related personnel expenses. We anticipate that a material portion of our expenses will continue to be denominated in shekels. In 2012, the shekel continued to fluctuate against the U.S. dollar. The shekel devaluated by approximately 3% against the U.S. dollar in the first half of the year and then appreciated by approximately 5% in the second half of the year. In total, during 2012, the shekel appreciated by approximately 2% against the U.S. dollar. If the U.S. dollar weakens against the shekel or other currencies we are exposed to, there will be a negative impact on our results of operations. We use derivative financial instruments, such as foreign exchange forward contracts, to mitigate the risk of changes in foreign exchange rates on balance sheet accounts and forecast cash flows. We may not purchase derivative instruments adequately to insulate ourselves from foreign currency exchange risks. The volatility in the foreign currency markets may make hedging our foreign currency exposures challenging. In addition, because a portion of our revenue is not earned in U.S. dollars, fluctuations in exchange rates between the U.S. dollar and the currencies in which such revenue is earned may have a material adverse effect on our results of operations and financial condition. If we wish to maintain the U.S. dollar-denominated value of our products in non-U.S. markets, devaluation in the local currencies of our customers relative to the U.S. dollar could cause our customers to cancel or decrease orders or default on payment.

Compliance with new regulations regarding the use of conflict minerals may disrupt our operations, result in additional cost and expense and could result in other significant adverse effects.

In August 2012, under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the U.S. Securities and Exchange Commission (the “SEC”) adopted new requirements for companies that use certain minerals and derivative metals (referred to as "conflict minerals" regardless of their actual country of origin) in their products. Metals, such as tantalum, tin, gold and tungsten may be present in our products as component parts. We will be required to implement procedures to investigate and disclose whether any conflict minerals that are used in our products originated from the Democratic Republic of the Congo or adjoining countries. There will be costs associated with these investigations, and the implementation of these rules could adversely affect the sourcing, supply and pricing of the raw materials used in our products. Also, we may face potential reputational challenges if we are unable to sufficiently verify the origins of all conflict minerals used in our component parts or if we are unable to replace any conflict minerals sourced from the Democratic Republic of the Congo or adjoining countries with acceptable alternatives. We may also encounter challenges to satisfy customers that require that all of the components of our products be certified as conflict-free. If we are not able to meet customer requirements, customers may choose an alternative service provider. These changes could also have an adverse impact in our ability to market our products.

Risks Related to Our Ordinary Shares

The share price of our ordinary shares has been and may continue to be volatile.

Our quarterly financial performance is likely to vary in the future, and may not meet our expectations or the expectations of analysts or investors, which may lead to additional volatility in our share price. The market price of our ordinary shares may be volatile and could fluctuate substantially due to many factors, including, but not limited to:

- announcements or introductions of technological innovations, new products, product enhancements or pricing policies by us or our competitors;
- winning or losing contracts with service providers;
- disputes or other developments with respect to our or our competitors' intellectual property rights;
- announcements of strategic partnerships, joint ventures or other agreements by us or our competitors;
- recruitment or departure of key personnel;
- regulatory developments in the markets in which we sell our products;
- our sale of ordinary shares or other securities in the future;
- changes in the estimation of the future size and growth of our markets; or
- market conditions in our industry, the industries of our customers and the economy as a whole.

Share price fluctuations may be exaggerated if the trading volume of our ordinary shares is too low. The lack of a trading market may result in the loss of research coverage by securities analysts. Moreover, we cannot assure you that any securities analysts will initiate or maintain research coverage of our company and our ordinary shares. If our future quarterly operating results are below the expectations of securities analysts or investors, the price of our ordinary shares would likely decline. Securities class action litigation has often been brought against companies following periods of volatility.

Our shareholders do not have the same protections afforded to shareholders of a U.S. company because we have elected to use certain exemptions available to foreign private issuers from certain NASDAQ corporate governance requirements.

As a foreign private issuer, we are permitted under NASDAQ Marketplace Rule 5615(a)(3) to follow Israeli corporate governance practices instead of the NASDAQ Stock Market requirements that apply to U.S. companies. As a condition to following Israeli corporate governance practices, we must disclose which requirements we are not following and the equivalent Israeli law requirement. We must also provide NASDAQ with a letter from our Israeli outside counsel, certifying that our corporate governance practices are not prohibited by Israeli law. As a result of these exemptions, our shareholders do not have the same protections as are afforded to shareholders of a U.S. company. We may also in the future choose to follow Israeli law and practices in lieu of other requirements of NASDAQ Rule 5600.

Our U.S. shareholders may suffer adverse tax consequences if we are characterized as a passive foreign investment company.

Although we did not use the market capitalization method to value our assets in 2009, as noted in our prior Form 20-Fs, we relied on the market capitalization method to determine the fair market value of our assets for the taxable year ended December 31, 2012. Based on certain estimates of our gross income and gross assets, the nature of our business and the anticipated amount of goodwill (which is determined in large part by the price of our stock), we believe that we were not a PFIC for our taxable year ended December 31, 2012 and do not expect to become a PFIC for our taxable year ending December 31, 2013. A non-U.S. company will generally be characterized as a PFIC for any taxable year in which 75% or more of its gross income is passive income or in which 50% or more of the average value of its gross assets produce passive income or are held for the production of passive income.

If we are characterized as a PFIC, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our ordinary shares treated as ordinary income, rather than capital gains income, and having potentially punitive interest charges apply to the proceeds of share sales. Similar rules apply to distributions that are "excess distributions."

The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of our future income, assets, activities and market capitalization, including fluctuations in the price of our ordinary shares, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC in 2013 or in subsequent years.

If the price of our ordinary shares declines, we may be more vulnerable to an unsolicited or hostile acquisition bid.

We do not have a controlling shareholder. Notwithstanding provisions of our articles of association and Israeli law, a decline in the price of our ordinary shares may result in us becoming subject to an unsolicited or hostile acquisition bid. In the event that such a bid is publicly disclosed, it may result in increased speculation regarding our company and volatility in our share price even if our board of directors decides not to pursue a transaction. If our board of directors does pursue a transaction, there can be no assurance that it will be consummated successfully or that the price paid will represent a premium above the original price paid for our shares by all of our shareholders.

Risks Relating to our Location in Israel

Conditions in Israel could adversely affect our business.

We are incorporated under Israeli law and our principal offices, research and development division and manufacturing facilities are located in Israel. Accordingly, political, economic and military conditions in Israel directly affect our business. Since the State of Israel was established in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity, which began in September 2000 and continued with varying levels of severity into 2012. An armed conflict between Israel and Hamas in the Gaza Strip occurred in November 2012 and is ongoing. These conflicts involved missile strikes against civilian targets in various parts of Israel including most recently, central Israel, and negatively affected business conditions in Israel. Any armed conflicts, terrorist activities or political instability in the region may limit materially our ability to obtain raw materials from these countries or sell our products to companies in these countries. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners, or significant downturn in the economic or financial condition of Israel, could adversely affect our operations and product development and manufacturing, cause our revenues to decrease and adversely affect the share price of publicly traded companies having operations in Israel, such as us.

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Our operations may be disrupted by the obligations of personnel to perform military service.

As of December 31, 2012, we employed 442 people, of whom 305 were based in Israel. Some of our employees in Israel are obligated to perform annual military reserve duty in the Israel Defense Forces, depending on their age and position in the army. Additionally, they may be called to active reserve duty at any time under emergency circumstances for extended periods of time. Our operations could be disrupted by the absence of one or more of our executive officers or key employees for a significant period due to military service and any significant disruption in our operations could harm our business. The full impact on our workforce or business if some of our executive officers and employees are called upon to perform military service, especially in times of national emergency, is difficult to predict. Additionally, the absence of a significant number of employees at our manufacturing subcontractor, Flextronix, as a result of military service obligations may disrupt their operations and could have a material adverse effect on our ability to timely deliver products to customers may be materially adversely affected.

The tax benefits that are available to us require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs and taxes.

Our investment program in equipment at our facility in Hod-Hasharon, Israel, has been granted approved enterprise status and we are therefore eligible for tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959, referred to as the Investments Law. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2012, our net operating loss carry forwards for Israeli tax purposes amounted to approximately $40 million (including losses related to our acquisition of Oversi, the operations of which were merged with ours in 2012). To remain eligible for these tax benefits, we must continue to meet certain conditions stipulated in the Investments Law and its regulations and the criteria set forth in the specific certificate of approval, including, among other conditions, that the approved enterprise be operated over a seven-year period and that at least 30% of our investment in fixed assets of the approved enterprise be funded by additional paid-up ordinary share capital. If we do not meet these requirements, the tax benefits would be canceled and we could be required to refund any tax benefits and investment grants that we received in the past. Further, in the future these tax benefits may be reduced or discontinued. If these tax benefits are cancelled, our Israeli taxable income would be subject to regular Israeli corporate tax rates. The standard corporate tax rate for Israeli companies in 2011 was 24% of their taxable income and was increased to 25% in 2012. In December 2011, the Israeli Parliament passed the Law for Tax Burden Reform (Legislative Amendments), 2011 which, among other provisions, canceled the scheduled progressive reduction in the corporate tax rate.. This law entered into effect as of December 31, 2011, and has had no material effect on our financial statements.

Effective January 1, 2011, the Investment Law was amended. Under the amended Investment Law, the criteria for receiving tax benefits were revised. Under the transition provisions of the new legislation, a company may decide to irrevocably implement the new amendment while waiving benefits provided under the current law or to remain subject to the current law. In the future, we may not be eligible to receive additional tax benefits under this law. Our Company did not file a request to apply the new benefits under the 2011 Amendment. We intend to apply for benefits under the 2011 Amendment beginning in 2015. The termination or reduction of these tax benefits would increase our tax liability, which would reduce our profits. Additionally, if we increase our activities outside of Israel through acquisitions, for example, our expanded activities might not be eligible for inclusion in future Israeli tax benefit programs. Finally, in the event of a distribution of a dividend from the abovementioned tax-exempt income, in addition to withholding tax at a rate of 15% (or a reduced rate under an applicable double tax treaty), we will be subject to tax at the corporate tax rate applicable to our Approved Enterprise's and Beneficiary Enterprise's income on the amount distributed in accordance with the effective corporate tax rate which would have been applied had we not enjoyed the exemption. See "ITEM 10: Additional Information—Taxation—Israeli Tax Considerations and Government Programs."

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No assurance can be given that we will be eligible to receive additional tax benefits under the Investments Law in the future. The termination or reduction of these tax benefits would increase our tax liability in the future, which would reduce our profits or increase our losses. Additionally, if we increase our activities outside of Israel, for example, by future acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefit programs.

The government grants we have received for research and development expenditures require us to satisfy specified conditions and restrict our ability to manufacture products and transfer technologies outside of Israel. If we fail to comply with these conditions or such restrictions, we may be required to refund grants previously received together with interest and penalties and may be subject to criminal charges.

We have received royalty-bearing grants from the government of Israel through the Office of the Chief Scientist, for the financing of a portion of our research and development expenditures in Israel, pursuant to the provisions of The Encouragement of Industrial Research and Development Law, 1984, referred to as the Research and Development Law. In 2010, 2011 and 2012, we received and accrued grants totaling $2.8 million, $3.7 million and $2.9 million from the Office of the Chief Scientist, representing 19.8%, 21.7% and 11.5%, respectively, of our gross research and development expenditures in these periods. We may not receive future grants or may receive significantly smaller grants from the Office of the Chief Scientist, and our failure to receive grants in the future could adversely affect our profitability. In December 2012, we recorded a liability for the early payment of approximately $15.9 million due to a settlement with the Office of the Chief Scientist, representing the full balance of the contingent liability related to grants. The settlement will be paid in 2013. Upon making this payment, we will eliminate all future royalty obligations related to our anticipated revenues and will not incur the expense associated with future interest payments related to such obligations.

The terms of the grants prohibit us from manufacturing products outside of Israel or transferring intellectual property rights in technologies developed using these grants inside or outside of Israel without special approvals.

Even if we receive approval to manufacture our products outside of Israel, we may be required to pay an increased total amount of royalties, which may be up to 300% of the grant amount plus interest, depending on the manufacturing volume that is performed outside of Israel. This restriction may impair our ability to outsource manufacturing or engage in similar arrangements for those products or technologies. Know-how developed under an approved research and development program may not be transferred to any third-parties, except in certain circumstances and subject to prior approval. In addition, if we fail to comply with any of the conditions and restrictions imposed by the Research and Development Law or by the specific terms under which we received the grants, we may be required to refund any grants previously received together with interest and penalties, and may be subject to criminal charges. In recent years, the government of Israel has accelerated the rate of repayment of the Office of Chief Scientist grants and may further accelerate them in the future.

It may be difficult to enforce a U.S. judgment against us, our officers and directors in Israel or the United States, or to assert U.S. securities laws claims in Israel or serve process on our officers and directors.

We are incorporated in Israel. The majority of our executive officers and directors are not residents of the United States, and the majority of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for an investor, or any other person or entity, to enforce a U.S. court judgment based upon the civil liability provisions of the U.S. federal securities laws against us or any of these persons in a U.S. or Israeli court, or to effect service of process upon these persons in the United States. Additionally, it may be difficult for an investor, or any other person or entity, to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws on the grounds that Israel is not the most appropriate forum in which to bring such a claim. Even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law

must be proved as a fact which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing the matters described above.

Provisions of Israeli law and our articles of association may delay, prevent or make undesirable an acquisition of all or a significant portion of our shares or assets.

Our articles of association contain certain provisions that may delay or prevent a change of control, including a classified board of directors. In addition, Israeli corporate law regulates acquisitions of shares through tender offers and mergers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law could delay or prevent a change in control and may make it more difficult for third-parties to acquire us, even if doing so would be beneficial to our shareholders, and may limit the price that investors may be willing to pay for our ordinary shares in the future. Furthermore, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders. See “ITEM 10: Additional Information—Memorandum and Articles of Association—Acquisitions under Israeli Law” and “—Anti-Takeover Measures.”

ITEM 4: Information on Allot

A. History and Development of Allot

Our History

Our legal and commercial name is Allot Communications Ltd. We are a company limited by shares organized under the laws of the State of Israel. Our principal executive offices are located at 22 Hanagar Street, Neve Ne’eman Industrial Zone B, Hod-Hasharon 4501317, Israel, and our telephone number is +972 (9) 761-9200. We have irrevocably appointed Allot Communications, Inc. as our agent to receive service of process in any action against us in any United States federal or state court. The address of Allot Communications, Inc. is 300 TradeCenter, Suite 4680, Woburn, MA 01801-7422.

We were incorporated on November 12, 1996 as “Ariadne Ltd.” and commenced operations in 1997. In September 1997, we changed our name to “Allot Communications Ltd.” In November 2006, we listed our shares on NASDAQ. In 2007, we introduced our Service Gateway platform that enables broadband providers to build efficient, secure, manageable and profitable intelligent networks that are optimized to deliver Internet-based content and services. In January 2008, we completed the acquisition of the business of Esphion Limited, a developer of network protection solutions for carriers and internet service providers. In November 2010, we listed our shares on the Tel Aviv Stock Exchange, or TASE, and began applying the reporting reliefs afforded under the Israeli Securities Law to companies whose securities are dually listed on NASDAQ and the TASE, In May 2012, we acquired the business of Ortiva Wireless Inc., a developer of video optimization solutions for mobile and Internet networks. In September 2012, we acquired the business of Oversi Networks Ltd., a developer of products and systems for caching Internet content.

We had capital expenditures of $3.8 million in 2012, $2.9 million in 2011 and $2.3 million in 2010. We have financed our capital expenditures with cash generated from operations and through net proceeds from sales of our equity securities.

Our capital expenditures during 2010, 2011 and 2012 consisted primarily of investments in lab equipment for research and development.

B. Business Overview

Overview

We are a leading global provider of intelligent broadband solutions, focused on developing mobile, fixed and enterprise networks to support the "digital lifestyle." The digital lifestyle describes the way people rely on broadband connectivity, Internet-connected devices and Internet applications in their everyday lives – at work, at home and at play. Our solutions, which are based on our deep packet inspection (DPI) technology, identify and leverage the business intelligence in data networks, empowering network operators to shape users' digital lifestyle experiences and to capitalize on the network traffic they generate.

We have a global and diverse end-customer base composed of mobile and fixed broadband service providers, cable operators, private networks, data centers, governments and enterprises, such as financial and educational institutions. Our scalable, carrier-grade solutions integrate capabilities that allow our customers to optimize the delivery and performance of over-the-top applications and services, monetize network utilization through value-added service deployment, real-time metering and application-aware charging models and personalize the user experience through service tiering and differentiation.

Through our combination of innovative technology, proven know-how and collaborative approach to industry standards and partnerships with broadband service providers and enterprises, we deliver broadband solutions that equip our customers with the capabilities to elevate their role in the digital lifestyle ecosystem and to expand into new business opportunities. We offer our customers proprietary technologies that are seamlessly woven into carrier-class products and solutions. In addition, we have developed significant industry know-how and expertise through our experience designing and implementing use cases with our diverse customer base. Beginning from the proposal stage of a new project through the testing, acceptance and implementation of our products, we collaborate closely with our customers and other industry participants to create innovative solutions to create the digital lifestyle ecosystems our customers require.

Industry Background

The rapid proliferation of broadband networks in recent years has been largely driven by demand from users for faster and more reliable access to the Internet and by the proliferation in the number and complexity of broadband applications, as well as the proliferation of mobile smartphones, tablets and other Internet-connected devices.

Rising Network Operational Costs Due to the Rapid Adoption of Broadband Applications

Advances in broadband access (such as the introduction of long-term evolution, or LTE, technology) combined with the advanced data capabilities of end-user devices (such as smartphones and tablets) have promoted a growing number of applications and content delivered over broadband networks. The vast majority of these applications run over-the-top (OTT) of the network, which means they are not originated, controlled or charged by the network operator. The use of OTT applications, such as streaming video, peer-to-peer (P2P), Voice over IP (VoIP), social networks, interactive gaming and online content, requires large and increasing amounts of bandwidth. Moreover, many of these applications are highly sensitive to network delays caused by congestion. In response to these challenges, service providers have been forced to invest heavily in network infrastructure upgrades and customer support services in order to maintain the quality of experience for subscribers.

Rising Data Traffic in Mobile Networks

The mobile data market continues to grow rapidly, fueled by the proliferation of smartphones and tablets, mobile-enabled laptops that use mobile modems or tethered smartphones to connect to the Internet. On average, the data traffic generated by an Internet user with a smartphone is multiple times that of an Internet user without a smartphone.

The cost of increasing the bandwidth in mobile networks is significantly higher than that in wireline networks. As a result, mobile operators are experiencing economic and infrastructure challenges in meeting the rising tide of data traffic over their networks. In addition, as capacity increases in mobile networks, smartphone users are likely to have increased expectations with respect to speed and performance.

It is becoming increasingly apparent that unmanaged 3G and 4G/LTE mobile networks, will not be able to cope with the rising tide of data traffic, without implementing intelligent bandwidth management solutions. Moreover, network providers may need to develop new pricing models if they are not able to monetize the OTT traffic carried by their networks.

Service Providers Demand the Ability to Offer Services that can be Monetized at Different Rates

Some service providers still offer flat-rate broadband access, regardless of the type of applications and data used by subscribers. These operators provide the same level of service to all subscribers and do not guarantee access quality, regardless of a subscriber's willingness to pay for premium services and network performance. However, with the increasing amount of data used, the flat-rate pricing model may not be profitable, especially for mobile broadband operators, unless they can charge subscribers high rates. As a result, both mobile and fixed operators have begun to offer service plans based on gigabytes of data used. However, this pricing model is also subject to competition from other service providers offering lower rates, contributing to downward pricing pressure and high subscriber turnover rates.

To address these issues and increase the average revenue per user (ARPU), a significantly increased number of service providers have begun to offer premium, differentiated services, such as improved quality for VoIP and Internet video, off-peak usage incentives and parental control over access to content, among others. By offering such tiered services and charging subscribers according to the value of these services, as well as based on the gigabyte usage, service providers can capitalize on the revenue opportunities enabled by OTT Internet applications. To offer premium services and to guarantee high-quality delivery of content and user experience, service providers need enhanced visibility into and control of network traffic, including visibility into the type of applications used on the network and levels of traffic generated by different subscribers.

The Challenge of Elevating the Role of Fixed and Mobile Broadband Networks

In the evolving digital lifestyle, consumers recognize the importance of the devices they use to access the Internet and choose the Internet content and services they use based on quality. However, the network that connects them to the Internet is not as "visible", and is therefore not as highly valued, even though it plays a critical role in the service chain. In order to generate revenue through various pricing models and encourage consumers and content providers to seek higher quality network services, service providers are seeking to elevate the role of network connectivity and services. To do so, service providers must be able to identify and leverage the business intelligence in their data networks and capitalize on the network traffic that they generate.

The ability to identify, distinguish and prioritize different applications plays a major role in intelligent management of network resources and service delivery, allowing service providers to optimize bandwidth utilization and reduce operational costs, while maintaining high quality of service for tiered and premium services. Application designers are employing increasingly sophisticated methods to avoid detection by network operators who desire to manage network use. Traditional network infrastructure devices, such as routers and switches, do not generally have sufficient computing resources or the required algorithms to distinguish between different and rapidly evolving applications.

Enterprise Demand for Visibility and Delivery of Mission-Critical Applications and Services in the Cloud

The proliferation of network applications, bring your own device (BYOD) and cloud computing presents significant challenges for enterprises that operate data centers, wide-area networks, virtual private networks (VPN) and Internet connectivity for organizations of all sizes. Enterprises depend on network infrastructure to ensure the delivery of business-critical applications to an increasingly mobile and often global workforce, and as such, face may of the same issues as service providers. At the same time, Internet access has introduced a wide variety of recreational and non-business applications to enterprise networks, resulting in network congestion and negatively impacting employee productivity. As a result, there is an increasing need for enterprises to be able to monitor and control the traffic on their business networks.

Network Security Threats

As reliance on the Internet has grown, service providers and subscribers have become increasingly vulnerable to a wide range of security threats, including denial of service (DOS) attacks, spambots and malware. These attacks are designed to flood the network with traffic that consumes all the available bandwidth and hinder the ability to provide high quality broadband access to subscribers or to prevent enterprises from using mission-critical applications. These threats also compromise network and data integrity. We believe service providers and enterprises must protect against such attacks by detecting and neutralizing malicious traffic at very early stages before such threats can compromise network integrity and services.

Integrated Solutions

Our integrated broadband solutions allow mobile, fixed and enterprise operators to elevate their role in the digital lifestyle ecosystem and expand into new business opportunities. Our solutions enable our customers to increase revenues by monetizing network usage through value-added services, value-based charging and revenue-sharing models, reduce costs by optimizing the delivery and performance of OTT content and cloud computing services and improve customer loyalty by personalizing operator offerings with various choices of service tiers and digital lifestyle options.

Our Integrated Solutions include:

- Analytics solutions deliver accurate and meaningful network business intelligence to drive capacity planning, congestion management, service planning and marketing decisions.

- Traffic Management solutions prioritize existing network capacity, control congestion and optimize service delivery. Dynamic Quality of Service (QoS) enforcement enables effective traffic management strategies that minimize infrastructure and operating costs.

- Video Caching and Optimization solutions improve the quality and efficiency of OTT video delivery. New revenue opportunities are created through service packages designed especially for video consumers and revenue-sharing possibilities with content providers.

- Policy Control and Charging solutions drive personalized service plans and pay-for-use pricing models based on real-time consumption of bandwidth and OTT applications. We provide a single point of integration with provisioning and pricing systems.

- Service Enablement solutions facilitate a wide variety of cost-saving and revenue-generating use cases to create personalized customer experiences demanded by today’s sophisticated consumers.

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Allot's Products (Our Platforms)

The Allot Service Gateway and Allot NetEnforcer platforms are based on leading technology and high performance, designed for in-line deployment in a wide range of networks. Within each platform, our Dynamic Actionable Recognition Technology (DART) engine employs multiple deep packet inspection and analytical methods to identify network traffic by subscriber, application, device and network topology. Our technology is able to identify more OTT applications than any other solution on the market with frequent and custom updates to our extensive signature library. These granular elements may be mapped directly into dynamic traffic management, charging and service enablement policies.

High-Performance Platforms

- Allot Service Gateway integrates network intelligence, policy enforcement and revenue-generating services in a scalable, carrier-class platform designed for fixed, mobile (3G/4G/LTE) and converged broadband networks. The Allot Service Gateway accurately identifies subscriber traffic in real time at speeds up to 160 gigabits per second (Gbps), optimizes bandwidth utilization based on usage, enforces QoS policy, and steers traffic to digital lifestyle services deployed within or outside the platform. As the focal point for service enablement, The Allot Service Gateway allows service providers to reduce operating costs and drive new revenue by delivering the personalized service and quality of experience that the digital lifestyle demands.

- Allot NetEnforcer bandwidth management devices monitor and manage network traffic per application and per subscriber, enabling intelligent optimization of broadband and wide area network (WAN) services. With full duplex speeds ranging from 10 megabits per second (Mbps) to 8 Gbps, these devices provide essential visibility policy enforcement and traffic steering to added-value services in a wide range of service provider and enterprise networks.

Digital Lifestyle Services

Our growing portfolio of digital lifestyle services operate seamlessly with our in-line platforms and centralized management system, providing new business opportunities for service providers and enterprises.

Subscriber Management Platform

The Allot Subscriber Management Platform (SMP) drives the centralized creation, provisioning and pricing of subscriber services, including tiered and usage-based data plans, which we believe are key to personalizing digital lifestyle offerings and maximizing average revenue per user. The Allot SMP allows subscriber traffic to be managed across converged access networks and when offloading to Wi-Fi hotspots. Modular licensing provides flexible and scalable management for any number of subscribers.

- Allot TierManager: Provisions and manages differentiated services and tiered service plans that are tailored to subscriber preferences.

- Allot QuotaManager: Provisions and manages usage allowances and caps, with real-time metering of service consumption and dynamic enforcement of quota limits and overage policy.

- Allot ChargeSmart: Enables real-time, pay-for-use pricing, based on a user's consumption of data and applications. It also integrates seamlessly in 3G and 4G mobile networks and implements the pricing model via standard telecommunication interfaces, such as Diameter Gx, Sd, Gy and Gz.

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Analytics Services

Our analytics services analyze traffic data to drive smart business decisions.

- Allot Data Mediator: Provides high-performance collection, storage, aggregation and export of usage data, session and pricing records to the Allot Proactive Analytics system or to any other analytics systems. Provides a rich data source for further analysis of user behavior.

- Allot Proactive Analytics: Performs in-depth analyses of Internet and subscriber usage records collected by Allot in-line platforms, together with individual demographics and profile data supplied by operator systems to better understand consumer preferences and user behavior.

Video Services

Our media caching and video optimization platforms enable operators to capitalize on the increasing volume of OTT video traffic.

- Allot MediaSwift E: Comprehensive caching and content delivery system for OTT video, P2P and other applications. Relieves network congestion caused by videos and improves quality of experience for users.

- Allot VideoClass: Optimizes OTT video content and delivery to ensure efficient utilization of mobile radio access network (RAN) resources and consistently high quality video to enhance viewer experience.

Security Services

Our security services protect network service integrity and brand reputation.

- Allot WebSafe: URL filtering service that blocks blacklisted content and enables access control to objectionable content on the Internet.

- Allot ServiceProtector: Attack detection and mitigation services that protect commercial networks against Denial of Service (DoS/DDoS) attacks, Zero Day attacks, worms, zombie and spambot behavior.

Centralized Management

The Allot NetXplorer is the management umbrella for our devices, platforms and services, providing a central access point for network-wide monitoring, reporting, analytics, troubleshooting, accounting and QoS policy provisioning. Its user-friendly interface provides our customers with a comprehensive overview of the application, user, device and network topology traffic, while its wide variety of reports provide accessible, detailed analyses of granular traffic data.

- NetXplorer Analytics and Reporting: Real-time reporting provides 30-second accuracy for timely troubleshooting and resolution of customer care issues, while historical traffic statistics facilitate analyses of usage trends and user behavior.

- NetXplorer Data Collector: Provides distributed data collection and storage at different points in the network in order to support growing and large-scale deployments with large volumes of network traffic.

- NetAccounting Server: Aggregates network-wide usage statistics and exports the data to external accounting systems in standard formats.

- NetPolicy Provisioner: Provides a virtual "bandwidth management device" for self-monitoring and self-provisioning by a networks operator's VPN, ISP and managed services customers

Customers

We have a global, diversified end-customer base consisting primarily of mobile and fixed service providers, cable operators, private networks, data centers, governments and enterprises. We derive a significant and growing portion of our revenue from direct sales to large mobile and fixed-line service providers. We generate the remainder of our revenue through a select and well-developed network of channel partners, generally consisting of distributors, resellers, original equipment manufacturers ("OEMs") and system integrators. In 2012, we derived 38% of our revenues from Europe, 24% from United States, 21% from Asia and Oceania, 10% from the Middle East and Africa and 7% from the Americas (excluding United States).

Channel Partners

We market and sell our products to end-customers both by direct sales and through channel partners, which include distributors, resellers, OEMs and system integrators. A significant portion of our sales occur through our channel partners. In 2012, approximately one-third of our revenues were derived from channel partners. Our channel partners generally purchase our products from us upon receiving orders from end-customers and are responsible for installing and providing initial customer support for our products. Our channel partners are located around the world and address most major markets. Our channel partners target a range of end-users, including carriers, alternative carriers, cable operators, private networks, data centers and enterprises in a wide range of industries, including government, financial institutions and education. Our agreements with channel partners that are distributors or resellers are generally non-exclusive, for an initial term of one year and automatically renew for successive one-year terms unless terminated. After the first year, such agreements may typically be terminated by either party upon ninety days prior notice.

We offer support to our channel partners. This support includes the generation of leads through marketing events, seminars and web-based leads and incentive programs as well as technical and sales training.

Sales and Marketing

Our product sales and deployment cycle varies based on the intended use by the end-customer. The sales cycle for initial network deployment may generally last between twelve and eighteen months for large and medium service providers, six to twelve months for small service providers, and one to six months for enterprises. Follow-on orders and additional deployment of our products usually require shorter cycles. Large and medium service providers generally take longer to plan the integration of our solutions into their existing networks and to set goals for the implementation of the technology.

We focus our marketing efforts on product positioning, increasing brand awareness, communicating product advantages and generating qualified leads for our sales organization. We rely on a variety of marketing communications channels, including our website, trade shows, industry research and professional publications, the press and special events to gain wider market exposure.

We have organized our worldwide sales efforts into the following three territories: North and South America, Europe the Middle East and Africa, and Asia and Oceania. We have regional offices in the United States, Israel, France,

United Kingdom, Singapore, Japan, New Zealand and China, and a regional presence in Germany, Italy, Spain, Mexico, Brazil, India, Hong Kong, South Korea, South Africa and Australia.

As of December 31, 2012, our sales and marketing staff, including product management and business development functions, consisted of 84 employees.

Service and Technical Support

We believe our technical support and professional services capabilities are a key element of our sales strategy. Our technical staff assists in presales activities and advises channel partners on the integration of our solutions into end-customer networks. Our basic warranty extended to end-customers (directly or through our channel partners) is three months for software and twelve months for hardware. Generally, end-customers are also offered a choice of one year or three-year customer support programs when they purchase our products. These customer support programs can be renewed at the end of their terms. Our end-customer support plans generally offer the following features:

- unlimited 24/7 access to Allot's support organization, via phone, emails and online support system;
- expedited replacement units in the event of a warranty claim;
- software updates and upgrades offering new features and addressing new and changing network applications; and
- periodic updates of solution documentation and technical information.

Our support plans are designed to maximize network up-time and minimize operating costs. Our customers, including channel partners and their end-customers, are entitled to take advantage of our around-the-clock technical support which we provide through our four help desks, primarily located in France, Israel, Singapore and the United States. We also offer our customers 24-hour access to an external web-based technical knowledge base, which provides technical support information and, in the case of our channel partners, enables them to support their customers independently and obtain follow up and support from us.

The expenditures associated with the technical support staff are allocated in our statements of operations between sale and marketing expenses and cost of goods sold, based on the roles of and tasks performed by personnel.

As of December 31, 2012, our technical staff consisted of 115 employees.

Research and Development

Our research and development activities take place primarily in Israel. As of December 31, 2012, 178 of our employees were engaged primarily in research and development. We devote a significant amount of our resources towards research and development to introduce and continuously enhance products to support our growth strategy. We have assembled a core team of experienced engineers, many of whom are leaders in their particular field or discipline and have technical degrees from top universities and experience working for leading Israeli networking companies. These engineers are involved in advancing our core technologies, as well as in applying these core technologies to our product development activities. Our research and development efforts have benefited from royalty-bearing grants from the Office of the Chief Scientist. The State of Israel does not own any proprietary rights in technology developed with the Office of the Chief Scientist funding and there is no restriction related to the Office of the Chief Scientist on the export of products manufactured using technology developed with Office of the Chief Scientist funding (other limitations on export apply under applicable law). For a description of restrictions on the transfer of the technology and with respect to manufacturing rights, please see "ITEM 3: Key Information—Risk Factors—The government grants we have received for research and development expenditures require us to satisfy specified conditions and restrict our ability to manufacture products and transfer technologies outside of Israel. If we fail to comply with these conditions or such restrictions, we may be required to refund grants previously received together with interest and penalties and

may be subject to criminal charges."

Manufacturing

We subcontract the manufacture and repair of our Service Gateway platforms and our NetEnforcer traffic management systems to Flextronics (Israel) Ltd., a subsidiary of Flextronics, a global electronics manufacturing services company. This strategy enables us to reduce our fixed costs, focus on our core research and development competencies and provide flexibility in meeting market demand. Flextronics (Israel) is contractually obligated to provide us with manufacturing services based on agreed specifications, including manufacturing, assembling, testing, packaging and procuring the raw materials for our devices. We are not required to provide any minimum orders. Our agreement with Flextronics (Israel) is automatically renewed annually for additional one-year terms. Flextronics (Israel) may terminate our agreement with them at any time during the term upon 180 days prior notice. We retain the right to procure independently any of the components used in our products. Flextronics (Israel) has a U.S. affiliate to which it can, with the prior consent of the Office of the Chief Scientist, transfer manufacturing of our products if necessary, in which event we may be required to pay increased royalties to the Office of the Chief Scientist. We expect that it would take approximately six months to transition manufacturing of our products to an alternate manufacturer.

We design and develop internally a number of the key components for our products, including printed circuit boards and software. Some of the hardware components of our products are obtained from single or limited sources. Since our products have been designed to incorporate these specific components, any change in these components due to an interruption in supply or our inability to obtain such components on a timely basis would require engineering changes to our products before we could incorporate substitute components. In particular, we purchase the central processing unit for our Service Gateway platforms and for our NetEnforcer products from NetLogic Microsystems, Inc. (now part of Broadcom Corporation). We carry approximately three to six months of inventory of key components. We also work closely with our suppliers to monitor the end-of-life of the product cycle for integral components, and believe that in the event that they announce end of life, we will be able to increase our inventory to allow enough time for replacing such components. The agreements with our suppliers do not contain any minimum purchase or supply commitments. Product testing and quality assurance is performed by our contract manufacturer using tests and automated testing equipment and according to controlled test documentation we specify. We also use inspection testing and statistical process controls to assure the quality and reliability of our products.

Competition

We compete in a rapidly evolving and highly competitive sector of the networking technology market. We face significant competition from router and switch infrastructure companies, such as Cisco Systems, Inc., Telefonaktiebolager LM Erricson and Huawei Technologies Co., Ltd. that integrate functionalities into their platforms addressing some of the problems that our products address. Our competitors have also identified the potential market opportunity offered by the largest service providers, referred to as Tier 1 operators, and we therefore expect intense competition in this portion of our market in the future. Our principal competitors in the field of DPI technology are Sandvine Inc. and Procera Networks, Inc. We also face competition from companies that offer partial or alternative solutions addressing limited aspects of the challenges facing broadband providers, such as network monitoring or security. We compete on the basis of product performance, such as speed and number of applications identified, ease of use and installation, and customer support. Price is also an important, although not the principal, basis on which we compete. See “ITEM 3: Key Information—Risk Factors—We may be unable to compete effectively with other companies in our market who offer, or may in the future offer, competing technologies.”

Intellectual Property

Our intellectual property rights are very important to our business. We believe that the complexity of our products and the know-how incorporated in them makes it difficult to copy them or replicate their features. We rely on a combination of confidentiality and other protective clauses in our agreements, copyright and trade secrets to protect our know-how. We also restrict access to our servers physically and through closed networks since our product designs and software are stored electronically and thus are highly portable.

We customarily require our employees, customers, distributors, resellers, software testers, technology partners and contractors to execute confidentiality agreements or agree to confidentiality undertakings when their relationship with us begins. Typically, our employment contracts also include the following clauses: assignment of intellectual property rights for all inventions developed by employees, non-disclosure of all confidential information, and non-compete clauses, which generally restrict the employee for six months following termination of employment. The enforceability of non-compete clauses in certain jurisdictions in which we operate may be limited. See “ITEM 3: Key Information—Risk Factors—We may not be able to enforce employees’ covenants not to compete under the current laws of some jurisdictions in which we operate and therefore may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.” Because our product designs and software are stored electronically and thus are highly portable, we attempt to reduce the portability of our designs and software by physically protecting our servers through the use of closed networks, which prevent external access to our servers.

The communications equipment industry is characterized by constant product changes resulting from new technological developments, performance improvements and lower hardware costs. We believe that our future growth depends to a large extent on our ability to be an innovator in the development and application of hardware and software technology. As we develop the next generation products, we intend to pursue patent protection for our core technologies in the telecommunications segment. We plan to seek patent protection in our largest markets and our competitors’ markets, for example in the United States and Europe. As we continue to move into markets, such as Japan, Korea and China, we will evaluate how best to protect our technologies in those markets. We intend to vigorously prosecute and defend the rights of our intellectual property.

As of December 31, 2012, we had two U.S. patents and four pending patent applications in the United States. We expect to formalize our evaluation process for determining which inventions to protect by patents or other means. We cannot be certain that patents will be issued as a result of the patent applications we have filed.

We have obtained a U.S. trademark registration for one of our key marks that we use to identify our products or services: “NetEnforcer.”

Government Regulation

See “ITEM 5: Overview—Government Grants” for a description of grants received from the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor.

C. Organizational Structure

As of December 31, 2012, we held directly and indirectly the percentage indicated of the outstanding capital stock of the following subsidiaries:

Company	Jurisdiction of Incorporation	Percentage Ownership
Allot Communications, Inc.	United States	100%
Allot Communication Europe SARL	France	100%
Allot Communications (Asia Pacific) Pte. Limited	Singapore	100%
Allot Communications (UK) Limited	United Kingdom	100%
Allot Communications Japan K.K.	Japan	100%
Allot Communications (New Zealand) Limited	New Zealand	100%
Ortiva Wireless Inc.	United States	100%
Oversi Networks Ltd.	Israel	100%

D. Property, Plants and Equipment

Our principal administrative and research and development activities are located in approximately 72,000 square foot (6,700 square meter) facilities in Hod-Hasharon, Israel. The leases for our facilities vary in dates and terms, with the main facility’s lease commencing in July 2006 and expiring in July 2013.

We also lease a 5,862 square foot (545 square meter) facility in Woburn, Massachusetts, for the purposes of our U.S. sales and marketing operations pursuant to a lease that expires in August 2014 and a 15,119 square foot (1,400 square meter) facility in San Diego, California for the purposes of our U.S research and development activities, which expires in April 2018. We lease other smaller facilities for the purpose of our development, sales and marketing and support activities in France, the United Kingdom, Italy, Germany, Singapore, Spain, China, Japan and New Zealand.

ITEM 4A: Unresolved Staff Comments

Not applicable.

ITEM 5: Operating and Financial Review and Prospects

A. Operating Results

Overview

We are a leading provider of intelligent Internet Protocol (“IP”) service optimization, monetization and personalization solutions for mobile, fixed and wireless broadband service providers and enterprises. Our portfolio of hardware platforms and software applications uses our proprietary deep packet inspection (“DPI”) technology, which we refer to as Dynamic Actionable Recognition Technology, or DART, to transform broadband connections or pipes into smart networks that can manage data traffic efficiently and rapidly deploy value-added services. End-customers use our solutions to create sophisticated policies to monitor network applications, enforce quality of service policies that guarantee mission-critical application performance, mitigate security risks and leverage network infrastructure investments. Demand from users for faster and more reliable access to the Internet, an increase in the number and complexity of broadband applications, and growth in mobile data-enhanced smartphones have resulted in the rapid proliferation of broadband access networks in recent years. Our carrier-class products are used by service providers to

offer subscriber-based and application-based tiered services that enable them to optimize their service offerings, reduce churn rates and increase ARPU.

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We market and sell our products through a variety of channels, including direct sales and through our channel partners, which include distributors, resellers, OEMs and system integrators. End customers of our products include carriers, mobile operators, cable operators, wireless, wireline and satellite Internet service providers, educational institutions, governments and enterprises. The resulting intelligent, content-aware broadband networks enable our customers to accurately monitor and manage IP traffic per application, subscriber, network topology and device.

In 2012, the primary driver of our growth was the mobile market, which was highlighted by our ongoing relationship with a global Tier 1 mobile operator group. Revenues from this customer in 2012 accounted for 14% of our total revenues.

Acquisition of Ortiva and Oversi

In 2012, we acquired the business of Ortiva Wireless Inc. (“Ortiva”), a developer of solutions for mobile and Internet networks and Oversi Networks Ltd. (“Oversi”), a developer of products and systems for caching Internet content. See note 1(b) to our consolidated financial statements for further information.

Revenues

We generate revenues from two sources: (1) sales of our network traffic management systems and our network management application suites, and (2) maintenance and support services, including installation and training. We generally provide maintenance and support services pursuant to a one- or three-year maintenance and support program, which may be purchased by customers at the time of product purchase or on a renewal basis.

We recognize revenues from product sales when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with respect to implementation remain, the fee is fixed or determinable and collection is probable. We typically grant a one-year hardware and three month software warranty on all of our products, or one-year hardware and software extended warranty to customers which purchase annual maintenance and support, and record a provision for warranty at the time the product’s revenue is recognized. We estimate the liability of possible warranty claims based on our historical experience. Warranty claims have to date been immaterial to our results of operations. Maintenance and support revenues are recognized on a straight-line basis over the term of the applicable maintenance and support agreement. See “—Critical Accounting Policies and Estimates—Revenue Recognition” below.

Customer concentration. We derived 14%, 15% and 30% of our total revenues in 2012, 2011 and 2010, respectively, from one global Tier 1 mobile operator group. The decrease in 2011 and 2012 is primarily attributable to an increase of the total revenues and to the timing of revenue recognition.

Geographical breakdown. The following table sets forth the geographic breakdown of our revenues by percentage for the periods indicated:

	Year Ended December 31,					
	2010		2011		2012	
United States	14	%	12	%	24	%
Europe	53		50		38	
Asia and Oceania	22		17		21	
Middle East and Africa	7		12		10	
Americas (excluding United States)	4		9		7	
Total	100	%	100	%	100	%

Cost of revenues and gross margins

Our products' cost of revenues consists primarily of costs of materials, manufacturing services and overhead, warehousing, product testing and royalties paid primarily to the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the Office of the Chief Scientist. Our services' cost of revenues consists primarily of salaries and related personnel costs for our customer support staff as well as the royalty payments mentioned above. We expect cost of revenues to increase as a result of an increase in our product and service revenues, an increase in sales of our higher end products, primarily our Service Gateway platforms, and sales of extended service suites to large customers that we expect will require additional personnel hiring and other operational expenditures related to such sales. Such increases may be partially offset by increased sales of our network management application suites as their related cost of revenues is generally lower. In addition, we are no longer obligated to make royalty payments to the Office of the Chief Scientist, as we reached a settlement with them in December 2012. The balance of the liability related to the grants received from the Office of Chief Scientist was approximately $15.9 million, which was recorded as cost of revenues for the year ended December 31, 2012. As a result, our gross margins as a percentage of revenues may decrease in the future.

Operating expenses

Research and development. Our research and development expenses consist primarily of salaries and related personnel costs, costs for subcontractor services, depreciation, rent and costs of materials consumed in connection with the design and development of our products. We expense all of our research and development costs as they are incurred. Our net research and development expenses are comprised of gross research and development expenses offset by financing through royalty-bearing grants from the Office of the Chief Scientist. Such participation grants are recognized at the time at which we are entitled to such grants on the basis of the costs incurred and included as a deduction of research and development expenses (see "—Government Grants" below). We believe that significant investment in research and development, including hiring high quality research and development personnel, is essential to our future success and expect that in future periods our research and development expenses will increase on an absolute basis.

Sales and marketing. Our sales and marketing expenses consist primarily of salaries and related personnel costs, travel expenses, costs associated with promotional activities such as public relations, conventions and exhibitions, rental expenses, depreciation and commissions paid to third parties. We intend to continue expanding our activities in the service provider market, and therefore we expect that sales and marketing expenses will increase on an absolute basis in the future as we hire additional sales, marketing and presale support personnel to continue to promote our brand, establish new marketing channels and expand our presence worldwide.

General and administrative. Our general and administrative expenses consist of salaries and related personnel costs, rental expenses, costs for professional services and depreciation. We expect these expenses to increase on an absolute basis as we hire additional personnel and incur additional costs related to the growth of our business as we increase our global presence. General and administrative expenses also include costs associated with corporate governance, tax and regulatory compliance, compliance with the rules implemented by the U.S. Securities and Exchange Commission (the "SEC"), NASDAQ and the Tel-Aviv Stock Exchange ("TASE") and premiums for our director and officer liability insurance.

Financial income (expenses), net

Financial income (expenses), net consists primarily of interest earned on our cash balances and other financial investments, foreign currency exchange gains or losses, gains or losses resulting from the sale of marketable securities and bank fees.

In 2012, we had $1.4 million financial income, net compared to $0.4 million financial income, net in 2011. The change is primarily attributed to interest income derived from the increase in our short-term bank deposits as a result of our investment of the cash received from our offering of ordinary shares completed in November 2011.

In addition, financial and other income (expenses), net, may fluctuate due to foreign currency exchange gains or losses, as well as interest rate changes. See "—Factors Affecting Our Performance."

Approved and Privileged Enterprise

Our facilities in Hod-Hasharon, Israel have been granted Approved Enterprise status under the Encouragement of Capital Investments Law, 1959 and enjoy certain tax benefits under this program. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2012, our net operating loss carry forwards for Israeli tax purposes totaled approximately $40.0million, which includes losses related to our acquisition of Oversi. As a result of our acquisition of Oversi, operating losses may be offset against taxable income annually with a limitation of up to 20% of the total accumulated loss but no more than 50% of our taxable income. Income derived from other sources, other than through our "Approved Enterprise" status, during the benefit period will be subject to the regular corporate tax rate.

Government Grants

Our research and development efforts have been financed, in part, through grants from the Office of the Chief Scientist under our approved plans in accordance with the Research and Development Law. Through December 31, 2012, we had received approval and recorded in our books grants totaling $30.8 million from the Office of the Chief Scientist, including $4.1 million attributed to NetReality products. Because the NetReality products will no longer be sold, the $4.1 million was cancelled, and we will not be obligated to repay this amount. Under Israeli law and the approved plans, royalties on the revenues derived from sales of all of our products are payable to the Israeli government, generally at the rate of 3.0% during the first three years and 3.5% beginning in the fourth year, up to the amount of the received grants as adjusted for fluctuation in the U.S. dollar/shekel exchange rate. The amounts received after January 1, 1999 bear interest at the twelve-month LIBOR as at the beginning of the year in which a grant is approved. Our obligation to pay these royalties is contingent upon actual sales of our products and no payment is required if no sales are made. In December 2012, we recorded a liability of $15.9 million due to a settlement with the Office of the Chief Scientist, representing the full balance of the contingent liability related to grants received. This settlement will be paid in 2013. Upon making this payment, we will eliminate all future royalty obligations related to our anticipated revenues and will not incur the expense associated future interest payments related to such obligations.

Factors Affecting Our Performance

Our business, financial position and results of operations, as well as the period-to-period comparability of our financial results, are significantly affected by a number of factors, some of which are beyond our control, including:

Customer concentration. We derived 14% of our total revenues in 2012 from one global Tier 1 mobile operator group. While we have some visibility into the likely scope of the customer's projects, our relationship is conducted solely on a

purchase order basis and we do not have any commitment for future purchase orders from this customer. The loss of such significant customer could harm our results of operations and financial condition.

Size of end-customers and sales cycles. We have a global, diversified end-customer base consisting primarily of service providers and enterprises. The deployment of our products by small and midsize enterprises and service providers can be completed relatively quickly with a limited number of NetEnforcer and/or Service Gateway systems compared to the number required by large service providers. In 2012, we have increased the portion of our sales to large service providers. Large service providers take longer to plan the integration of our solutions into their existing networks and to set goals for the implementation of the technology. Sales to large service providers are therefore more complicated as they involve a relatively larger number of network elements and solutions, as well as NetEnforcer and/or Service Gateway systems. We are seeking to achieve further significant customer wins in the large service provider market that would positively impact our future performance. The longer sales cycles associated with the increased sales to large service providers of our platforms may increase the unpredictability of the timing of our sales and may cause our quarterly and annual operating results to fluctuate if a significant customer delays its purchasing decision and/or defers an order. Furthermore, longer sales cycles may result in delays from the time we increase our operating expenses and make investments in inventory to the time that we generate revenue from related product sales.

Average selling prices. Our performance is affected by the selling prices of our products. We price our products based on several factors, including manufacturing costs, the stage of the product's life cycle, competition, technical complexity of the product, discounts given to channel partners in certain territories, customization and other special considerations in connection with larger projects. We typically are able to charge the highest price for a product when it is first introduced to the market. We expect that the average selling prices for our products will decrease over the product's life cycle as our competitors introduce new products and DPI technology becomes more standardized. In order to maintain or increase our current prices, we expect that we will need to enhance the functionality of our existing products by offering higher system speeds, additional value-added services and features, such as additional security functions, supporting additional applications and providing enhanced reporting tools. We also from time to time introduce enhanced products, typically higher-end models that include new architecture and design and new capabilities. Such enhanced products typically increase our average selling price. To further offset such declines, we sell maintenance and support programs for our products, and as our customer base and number of field installations grow, our related service revenues are expected to increase.

Cost of revenues and cost reductions. Our cost of revenues as a percentage of total revenues was 28.1% for 2010, 28.5% for 2011and 44.8% in 2012 (29.6% excluding the impact of the $15.9 million expenses related to settlement of Office of Chief Scientist grants). Our products use off-the-shelf components and typically the prices of such components decline over time. However, the introduction and sale of new or enhanced products and services may result in an increase in our cost of revenues. We make a continuous effort to identify cheaper components of comparable performance and quality. We also seek improvements in engineering and manufacturing efficiency that will reduce costs. Our products incorporate features that require the payment of royalties to third parties. In addition, new products usually have higher costs during the initial introduction period. We generally expect such costs to decline as the product matures and sales volume increases. The introduction of new products may also involve a significant decrease in demand for older products. Such a decrease may result in a devaluation or write-off of such older products and their respective components. In 2012, we recorded a write-off of $1.4 million of inventory to our cost of revenues for products and components. The growth of our customer base is usually coupled with increased service revenues primarily resulting from increased maintenance and support. In addition, the growth of our installed base with large service providers may result in increased demand for professional services, such as training and installation services. An increase in demand for such services may require us to hire additional personnel and incur other expenditures. However, these additional expenses, handled efficiently, may be utilized to further support the growth of our customer base and increase service revenues.

Currency exposure. A majority of our revenues and a substantial portion of our expenses are denominated in the U.S. dollar. However, a significant portion of the expenses associated with our global operations, including personnel and facilities-related expenses, are incurred in currencies other than the U.S. dollar. This is the case primarily in Israel and to a lesser extent in other countries in Europe and Asia. Consequently, a decrease in the value of the U.S. dollar relative to local currencies will increase the dollar cost of our operations in these countries. A relative decrease in the value of the U.S. dollar would be partially offset to the extent that we generate revenues in such currencies. In order to partially mitigate this exposure we have decided in the past and may decide from time to time in the future to enter into hedging transactions. We may discontinue hedging activities at any time. As such decisions involve substantial judgment and assessments primarily regarding future trends in foreign exchange markets, which are very volatile, as well as our future level and timing of cash flows of these currencies, we cannot provide any assurance that such hedging transactions will not affect our results of operations when they are realized. See Note 5 to our consolidated financial statements included elsewhere in this annual report for further information.

Interest rate exposure. We have a significant amount of cash that is currently invested primarily in interest bearing vehicles, such as bank time deposits and available for sale marketable securities. These investments expose us to risks associated with interest rate fluctuations.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, or U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and judgments are subject to an inherent degree of uncertainty and actual results may differ. Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this annual report. Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. Those estimates are based on our historical experience, the terms of existing contracts, our observance of trends in our industry, information provided by our customers and information available from other outside sources, as appropriate. With respect to our policies on revenue recognition and warranty costs, our historical experience is based principally on our operations since we commenced selling our products in 1998. Our estimates are primarily guided by observing the following critical accounting policies:

- Revenue recognition;
- Warranty costs;
- Allowance for doubtful accounts;
- Accounting for stock-based compensation;
- Inventories;
- Marketable securities;
- Impairment of goodwill and long lived assets;
- Income taxes; and

- Contingencies.

Because each of the accounting policies listed above requires the exercise of certain judgments and the use of estimates, actual results may differ from our estimations and as a result would increase or decrease our future revenues and net income.

Revenue recognition. We generate revenues mainly from the sale of our products along with related maintenance and support services. At times, these arrangements may also include professional services, such as installation services or training. We sell our products through resellers, distributors, OEMs and system integrators, all of whom are considered end-customers from our perspective.

Revenues from product sales are recognized when persuasive evidence of an agreement exists, title and risk of loss have transferred to the customer, no significant performance obligations remain, payment for products is not contingent upon performance of installation or service obligations, the fee is fixed or determinable and collectability is probable. In instances where final acceptance of the product or service is specified by the customer, we do not recognize the revenue until all acceptance criteria have been met.

Maintenance and support-related revenues included in multiple element arrangements are deferred and recognized on a straight-line basis over the term of the applicable maintenance and support agreement. Revenues from other services are recognized upon the completion of installation or when the respective service is provided. In instances where the services provided in a multiple element arrangement are considered essential to the functionality of the product and payment for the product is contingent upon performance of the services, the sales of the products and services are considered one unit of accounting. Deferred revenues are classified as short and long term and recognized as revenues at the time respective elements are provided.

Under historical accounting principles, we were required to account for sales of its products in accordance with ASC 985-605. ASC 985-605 generally required revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative objective fair value of the elements. Accordingly, revenues were allocated to the different elements in the arrangement under “the residual method” when Vendor Specific Objective Evidence (“VSOE”) of fair value exists for all undelivered elements and no VSOE exists for the delivered elements.

Under the residual method, at the outset of the arrangement with a customer, we deferred revenues for the VSOE of its undelivered elements (maintenance and support) and recognized revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (hardware and software products).

In October 2009, the FASB issued ASU 2009-14, “Certain Arrangements That Include Software Elements, (amendments to ASC Topic 985, Software)” (ASU 2009-14), which changes the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product’s essential functionality is no longer within the scope of the software revenue guidance in Subtopic 985-605 of the Codification. Accordingly, we are outside of the scope of Subtopic 985-605. Since 2011, pursuant to the guidance of ASU 2009-13, “Multiple-Deliverable Revenue Arrangements, (amendments to ASC Topic 605, Revenue Recognition)” (ASU 2009-13) and ASU 2009- 14, when a sales arrangement contains multiple elements, such as products and services, we allocate revenues to each element based on a selling price hierarchy. The selling price for a deliverable is based on: (1) VSOE, if available, (2) third party evidence (‘‘TPE’’) if VSOE is not available or (3) the estimated selling price (‘‘ESP’’) if neither VSOE nor TPE is available. In multiple element arrangements, revenues are allocated to each separate unit of accounting for each of the deliverables using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy.

As of January 1, 2011, we changed our pricing policy in respect of the sale of maintenance and support services in new, multiple-element arrangements. For maintenance and support services under the new pricing policy, we determined the ESP for the year ended December 31, 2011 in multiple-element arrangements based on our review of historical transactions and considering several other external and internal factors including, but not limited to, pricing practices such as discounting and competition. For maintenance and support services in the year ended December 31, 2012, we determined the selling price based on VSOE of the price charged based on standalone sales of such elements

using a consistent percentage of our product price lists (renewals) in the same territories. The selling price of products was determined based on the ESP, as neither VSOE nor TPE was available. The ESP was determined by reviewing historical transactions and considering multiple other factors, including but not limited to, pricing practices including discounting and competition.

We provide a provision for product returns and stock rotation based on its experience with historical sales returns, stock rotations and other known factors. Such provisions amounted to $4.1 million and $2.6 million as of December 31, 2012 and 2011, respectively.

Warranty costs. We typically grant a one-year hardware and three month software warranty on all of our products, or one-year hardware and software extended warranty to customers which purchase annual maintenance and support, and record a provision for warranty at the time the product's revenue is recognized. We estimate the liability of possible warranty claims based on our historical experience. We estimate the costs that may be incurred under our warranty arrangements and record a liability in the amount of such costs at the time product revenue is recognized. We periodically assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Allowance for doubtful accounts. We evaluate the collectability of our accounts receivable on a specific basis. We estimate this allowance based on our judgment as to our ability to collect outstanding receivables. We primarily base this judgment on an analysis of significant outstanding invoices, the age of the receivables, our historical collection experience and current economic trends. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific allowance against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected.

Accounting for stock-based compensation. We account for stock-based compensation in accordance with Accounting Standards Codification No. 718, "Compensation - Stock Compensation" ("ASC No. 718") that 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 our consolidated statement of operations. We recognize compensation expense for the value of its awards granted based on the straight-line 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 the grant and revised in subsequent periods if actual forfeitures differ from those estimates.

In connection with the grant of options, we recorded total stock-based compensation expense of $2.0 million in 2010, $2.3 million in 2011and $4.8 million in 2012. In 2012, $0.2. million, $1.2 million, $2.1 million and $1.3 million of our stock-based compensation expense resulted from cost of revenue, research and development expenses, net, sales and marketing expenses and general and administrative expenses, respectively, based on the department in which the recipient of the option grant was employed. As of December 31, 2012, we had an aggregate of $19.0 million of deferred unrecognized stock-based compensation remaining to be recognized over a weighted average vesting period of 2.13 years.

Inventories. We value our inventories at the lower of cost or estimated market value. Cost is determined based on the First In, First Out ("FIFO") cost method for raw materials and out-of-pocket manufacturing costs. Indirect costs are allocated on an average basis. We estimate market value based on our current pricing, market conditions and specific customer information. We write off inventory for slow-moving items or technological obsolescence. We also assess our inventories for obsolescence based upon assumptions about future demand and market conditions. Actual future results may differ from our assessments and result in further devaluations or write-downs that will affect our future results of operations. Once inventory is written off, a new cost basis for these assets is established for future periods. Inventory write-offs totaled $1.1 million in 2010, $0.5 million in 2011 and $1.4 million in 2012.

Marketable securities. We account for our investments in marketable securities using Accounting Standards Codification No. 320, “Investments – Debt and Equity Securities” (“ASC No. 320”).

We determine the appropriate classification of marketable securities at the time of purchase and evaluate such designation as of each balance sheet date. We classify all of our investments in marketable securities as available for sale. Available for sale securities are carried at fair value, with 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 earnings 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, if any.

As of December 31, 2012, we held available for sale marketable securities of $14.8 million. As of December 31, 2012, the unrealized gain recorded to other comprehensive income was 15 million.

Impairment of goodwill and long lived assets. Goodwill represents the excess of the purchase price over the fair value of net assets of purchased businesses. Under Accounting Standards Codification No. 350, “Intangibles-Goodwill and Other” (“ASC No. 350”), goodwill and intangible assets deemed to have indefinite lives are tested for impairment annually, or more often if there are indicators of impairment present.

We perform an annual impairment analysis of goodwill at December 31 of each year, or more often as applicable. We operate in one operating segment, and this segment comprises only reporting unit. The provisions of ASC No. 350 require that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and no further testing is required to be performed. If the carrying value of the net assets exceeds the fair value, then we must perform the second step of the impairment test in order to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference.

We believe that our business activity and management structure meet the criterion of being a single reporting unit for accounting purposes. We performed an annual impairment analysis as of December 31, 2012 and determined that the carrying value of the reporting unit was less than the fair value of the reporting unit. Fair value is determined using market capitalization. During the years ended 2010, 2011 and 2012, no impairment losses were recorded.

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. As of December 31, 2012, no impairment losses have been identified.

Intangible assets acquired in a business combination are recorded at fair value at the date of the 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. Some of the acquired intangible assets are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in accelerated amortization of such customer relationships and backlog 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.

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

We have accumulated operating loss carry forwards of approximately $40.0 million and capital losses of approximately $27.3 million for tax purposes as of December 31, 2012, which may be carried forward and offset against taxable capital gains in the future for an indefinite period. In the United States, the accumulated losses for U.S. federal income tax return purposes were approximately $7.3 million as of December 31, 2012, which expire between 2026 and 2031. In France, we had approximately $3.5 million in net operating loss carry forwards as of December 31, 2012, which may be carried forward and offset against taxable capital gains in the future for an indefinite period. We believe that because of our history of losses, and uncertainty with respect to future taxable income, it is more likely than not that some of the deferred tax assets regarding the loss carry forwards will not be utilized in the foreseeable future, and therefore, a valuation allowance was provided to reduce deferred tax assets to their realizable value. The valuation allowance for the year ended December 31, 2012 was $8.7 million.

ASC No. 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. We recognize interest and penalties related to unrecognized tax benefits in our provision for income tax.

Contingencies. From time to time, we are a defendant or plaintiff in various legal actions, which arise in the normal course of business. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required for these contingencies, if any, which would impact our results of operations, is made after considered analysis of each individual action together with our legal advisors. The required reserves may change in the future due to new developments in each matter or changes in circumstances and estimations. A change in the required reserves would impact our results of operations in the period the change is made.

Results of Operations

The following table sets forth our statements of operations as a percentage of revenues for the periods indicated:

	Year Ended December 31, 2010		2011		2012	
Revenues:						
Products	71.7	%	73.1	%	73.6	%
Services	28.3		26.9		26.4	
Total revenues	100.0		100.0		100.0	
Cost of revenues:						
Products	24.6		25.1		25.6	
Services	3.5		3.4		4.0	
Total cost of revenues	28.1		28.5		44.8	
Gross profit	71.9		71.5		55.2	
Operating expenses:						
Research and development, net	19.8		17.1		21.1	
Sales and marketing	38.7		34.1		32.5	
General and administrative	9.6		9.6		10.2	
Total operating expenses	68.1		60.8		63.8	
Operating profit (loss)	3.8		10.7		(8.6	)
Financing income (expenses), net	(13.8	)	0.5		(1.3	)
Profit (loss) before income tax expense (benefit)	(10.0	)	11.2		(7.3	)
Income tax expense (benefit)	0.1		(0.1	)	(0.9	)
Net profit (loss)	(10.1	)%	11.3	%	(6.4	)%

Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

Revenues

Products. Product revenues increased by $20.3 million, or 35.8%, to $77.1million in 2012 from $56.8 million in 2011. The increase is primarily attributable to increased sales of our high-end products, primarily the Service Gateway platforms and value added products (such as Service Protector and MediaSwift), driven by orders placed by Tier 1 operator group and leading operators in North America, Latin America, Africa and East Asia. Video optimization and caching products sales, driven from the acquisitions of Ortiva and Oversi contributed to the increased sales in the second half of 2012.

Services. Services revenues increased by $6.7 million, or 31.9%, to $27.6 million in 2012 from $20.9 million in 2011. The increase in service revenues is primarily attributable to an increase in our installed base in 2012 and services revenues related to video optimization and caching products, driven from the acquisitions.

Product revenues comprised 73.6% of our total revenues in 2012, an increase of 0.6% compared to 2011 while services revenues' portion of total revenues decreased by the same percentage.

During 2012, revenues in Europe increased by $1.2 million, or 3.2%, compared to 2011. Revenues in the Americas (excluding the United States) increased by $1.0 million, or 13.9%, in 2012 compared to 2011, and revenues in Asia and Oceania increased by $8.6 million, or 64.0%, in 2012 compared to 2011. Revenues in the Middle East and Africa increased by $1.0 million, or 10.9%, compared to 2011. Revenues in the United States increased by $15.2 million, or

160.2%, compared to 2011, which was primarily attributable to orders placed by a leading operator.

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Cost of revenues and gross margin

Products. Cost of product revenues increased by $7.3 million, or 37.4%, to $26.9 million in 2012 from $19.5 million in 2011. In December 31, 2012 we recorded a liability related to settlement of the Office of Chief Scientist grants of approximately $15.9 million to be paid in 2013. Excluding the non-recurring payment to the Office of Chief Scientist, the increase in cost of revenues is consistent with the increase in product revenues. Product gross margin, decreased to 65.2% in 2012 from 65.6% in 2011.

Services. Cost of service revenues increased by $1.5 million, or 58.6 %, to $4.2 million in 2012 from $2.6 million in 2011. This increase is primarily attributable to higher support personnel expenses associated with deployment of our products with large service providers. In 2012, services gross margin decreased to 84.9% from 87.4% in 2011.

Total gross margin, excluding the impact of the settlement, decreased to 70.4% in 2012 from 71.4% in 2011.

Operating expenses

Research and development. Gross research and development expenses increased by $8.0 million, or 47.5%, to $24.9 million in 2012 from $16.9 million in 2011. This increase is primarily attributable to an increase in salaries and labor costs of approximately $5.4 million, which principally resulted from an increase in head count derived mainly from the acquisition of Ortiva and Oversi, which have significant research and development departments. In addition, other overhead expenses increased by $1.0 million, costs of contractors increased by $0.8 million and stock-based compensation increased by $0.8 million and depreciation.

Research and development expenses, net of received and accrued grants from the Office of the Chief Scientist, increased by $8.8 million, or 66.8%, to $22.1 million in 2012 from $13.2 million in 2011. Grants received from the Office of the Chief Scientist totaled $2.9 million in 2012 compared to $3.7 million in 2011. The decrease in grants received is attributable to a decrease in the approved grants from the Office of the Chief Scientist due to the settlement reached with them. We did not receive grants from the Office of Chief Scientist during the fourth quarter of 2012, and accordingly did not record accrued grants for this period. Research and development expenses, net, as a percentage of revenues increased to 21.1% in 2012 from 17.0% in 2011.

Sales and marketing. Sales and marketing expenses increased by $7.6 million, or 28.6%, to $34.1 million in 2012 from $26.5 million in 2011. This increase is primarily attributable to increased salaries and related expenses of approximately $5.3 million due to increased head count from the acquisitions of Ortiva and Oversi and new recruitments of sales and pre sales personnel. Stock-based compensation increased by $1.0 million, commission expense increased by $0.8 million, and travel and other expenses increased by $0.5 million.

Sales and marketing expenses, as a percentage of total revenues decreased to 32.6% in 2012 from 34.1% in 2011.

General and administrative. General and administrative expenses increased by $3.2 million, or 42.7%, to $10.7 million in 2012 from $7.5 million in 2011. This increase is attributable to increased professional services of approximately $1.0 million resulted from non-recurring legal and finance expenses related to acquisition activity. Wage expenses increased by approximately $1.0 million due to increased head count. Stock-based compensation increase approximately $0.6 million. Travel and other overhead expenses increased by $0.6 million.

General and administrative expenses as a percentage of revenues increased to 10.2% in 2012 from 9.6% 2011.

Financial expenses (income), net. Financial and other income, net in 2012 was $1.4 million income compared to $0.4 million in 2011. The increase is primarily attributable to interest income received from increased investments in short-term bank deposits as a result of the cash received from our offering of ordinary shares in November 2011.

Income tax benefit. Income tax benefit in 2012 was $1.0 million, compared to income tax benefit of $0.1 million in 2011. The change is primarily due to an increase in deferred tax assets related to our net operating losses expected to be utilized in the future.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Revenues

Products. Product revenues increased by $15.9 million, or 38.9%, to $56.8 million in 2011 from $40.9 million in 2010. The increase is primarily attributable to increased sales of our high-end products, primarily the Service Gateway platforms and value added services (such as Service Protector and MediaSwift), driven by orders placed by Tier 1 operator group and leading operators in EMEA, the Americas and the United States.

Services. Services revenues increased by $4.8 million, or 29.8%, to $20.9 million in 2011 from $16.1 million in 2010. The increase in services revenues is primarily attributable to an increase in our installed base in 2011.

Product revenues comprised 73.1% of our total revenues in 2011, an increase of 1.4% compared to 2010 while services revenues' portion of total revenues decreased by the same percentage.

During 2011, revenues in Europe increased by $8 million, or 26.3%, compared to 2010, which was primarily attributable to orders placed by a Tier 1 operator group. Revenues in the Americas (excluding the United States) increased by $4.4 million, or 176%, in 2011 compared to 2010, which was primarily attributable to orders from a leading operator, and revenues in Asia and Oceania increased by $0.9 million, or 7.2%, in 2011 compared to 2010. Revenues in the Middle East and Africa increased by $5.6 million, or 144%, compared to 2010 due to increased orders in the region. Revenues in the United States increased by $1.8 million, or 23.4%, compared to 2010, which was primarily attributable to orders placed by a leading operator.

Cost of revenues and gross margin

Products. Products cost of revenues increased by $5.5 million, or 39.3%, to $19.5 million in 2011 from $14.0 million in 2010. This increase is consistent with the increase in product revenues. Product gross margin slightly decreased to 65.7% in 2011 from 65.8% in 2010.

Services. Services cost of revenues increased by $0.6 million, or 30 %, to $2.6 million in 2011 from $2.0 million in 2010. This increase is primarily attributable to higher support personnel expenses associated with deployment of our products with large service providers. In 2011 services gross margin was 87.6%, the same level as in 2010.

Total gross margin slightly decreased to 71.5% in 2011 from 71.9% in 2010. This decrease is primarily attributable to the decrease in products gross margin as described above.

Operating expenses

Research and development. Gross research and development expenses increased by $2.9 million, or 20.7%, to $16.9 million in 2011 from $14.0 million in 2010. This increase is primarily attributable to an increase in salaries and labor costs of approximately $1.5 million, which principally resulted from an increase in head count. In addition, costs of

materials and contractors increased by $0.6 million and depreciation and other overhead expenses increased by $0.8 million.

Research and development expenses, net of received and accrued grants from the Office of the Chief Scientist, increased by $1.9 million, or 16.8%, to $13.2 million in 2011 from $11.3 million in 2010. Grants received from the Office of the Chief Scientist totaled $3.7 million in 2011 compared to $2.8 million in 2010. The increase in grants received is attributable to an increase in the approved grants from the Office of the Chief Scientist. Research and development expenses, net, as a percentage of revenues decreased to 17.1% in 2011 from 19.8% in 2010.

Sales and marketing. Sales and marketing expenses increased by $4.5 million, or 20.5%, to $26.5 million in 2011 from $22.0 million in 2010. This increase is primarily attributable to increased salaries and related expenses due to increased head count as a result from revenue increase during 2011 of approximately $3.6 million. Travel expenses increased by approximately $0.7 million resulting from increased personnel. Marketing expenses increased by approximately $0.2 million.

Sales and marketing expenses, as a percentage of total revenues decreased to 34.1% in 2011 from 38.7% in 2010.

General and administrative. General and administrative expenses increased by $2.0 million, or 36.6%, to $7.5 million in 2011 from $5.5 million in 2010. This increase is primarily attributable to increased professional services of approximately $1.5 million resulted from non-recurring legal and finance expenses related to acquisition activity and our secondary public offering completed in 2011. Wage expenses increased by approximately $0.2 million due to increased head count. Travel and other overhead expenses increased by $0.3 million.

General and administrative expenses as a percentage of revenues was 9.6% in 2011, the same rate as in 2010.

Financial expenses (income), net. Financial expenses (income), net in 2011 is $0.4 million income vs. $7.9 million expense in 2010. The decrease is primarily attributable to a loss in the amount of $7.7 million related to our investment in ARS in 2010, and an increase of $0.6 million in interest on deposits, foreign currency transaction differences and other related financial income.

Income tax expense (benefit). Income tax benefit in 2011 is $0.1 million, compared to income tax expenses of $0.1 million in 2010. The change is primary as a result of change in deferred taxes, offset by deduction of withholding tax asset.

B. Liquidity and Capital Resources

In November 2011, we completed a public offering which resulted in net proceeds of approximately $85.0 million, net of issuance costs.

As of December 31, 2012, we had $50.0 million in cash and cash equivalents, $14.8 million available for sale marketable securities, $0.1 million in restricted cash and $78.0 million short-term deposits. As of December 31, 2012, our working capital, which we calculate by subtracting our current liabilities from our current assets, was $131.6 million.

Based on our current business plan, we believe that our existing cash balances, will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. If our estimates of revenues, expense or capital or liquidity requirements change or are inaccurate and are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or arrange additional debt financing. In addition, we may seek to sell additional equity or arrange debt financing to give us financial flexibility to pursue attractive acquisitions or investment opportunities that may arise in the future.

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Operating activities.

During 2012, we generated $8.7 million in cash and cash equivalents from operating activities. Net cash provided by operating activities consisted of a net loss of $6.7 million, an increase of $15.9 million in liability related to settlement of the Office of Chief Scientist grants, depreciation and amortization of intangible assets of $5.1 million, $4.8 million of stock-based compensation expense, a decrease of $3.2 million in inventory and an increase of $2.4 million in employees and payroll accruals. This was partially offset by an increase of $8.1 million in trade receivables, a decrease of $7.1 million in deferred revenues attributed to sales which revenue recognition criteria were met while cash was collected in the previous years and a decrease of $1.3 million in trade payables.

During 2011, we generated $15.2 million in cash and cash equivalents from operating activities. Net cash provided by operating activities consisted of a net income of $8.8 million, depreciation and amortization of fixed and intangible assets of $2.9 million, $2.3 million of stock-based compensation expense and an increase of $7.4 million in deferred revenues attributable to sales for which we received cash but the revenue recognition criteria has not been met. This was partially offset by an increase of $1.1 million in other receivables and prepaid expenses, a decrease of $2.5 million in trade payable, an increase of $1.2 million in trade receivables and a decrease of $1.2 million in other payables and accrued expenses.

Investing activities.

Net cash used in investing activities in 2012 was $79.3 million, primarily attributable to the investment in short-term bank deposits of $54.0 million, cost of acquiring Ortiva and Oversi of $24.9 million, an investment in available-for sale marketable securities of $8.2 million and the purchase of property and equipment of $3.8 million. The above changes were partially offset by redemption of marketable securities of $10.7 million.