

RADCOM LTD
Form 20-F
April 22, 2013

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report _____

Commission file number 0-29452

RADCOM LTD.
(Exact Name of Registrant as Specified in its Charter)

N/A
(Translation of Registrant's Name into English)

Israel
(Jurisdiction of Incorporation or Organization)

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

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24 Raoul Wallenberg Street, Tel Aviv 69719, Israel

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary Shares, NIS 0.20 par value per share	NASDAQ Capital 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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: As of December 31, 2012, there were 6,449,780 Ordinary Shares, NIS 0.20 par value per share, outstanding.

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

Yes No

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

Yes No

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

U.S. GAAP

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

Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant elected to follow.

Item 17

Item 18

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

Yes No

INTRODUCTION

Except for the historical information contained herein, the statements contained in this annual report on Form 20-F (this "Annual Report") are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, with respect to our business, financial condition and results of operations. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Item 3.D—Key Information — Risk Factors" and elsewhere in this Annual Report.

The terms "believe," "do not believe," "expect," "plan," "intend," "estimate," "anticipate" and similar expressions are intended to identify forward-looking statements. These statements reflect our current views regarding future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

As used in this Annual Report, the terms "we," "us," "our," "RADCOM" and the "Company" mean RADCOM Ltd. and its subsidiaries, unless otherwise indicated.

Omni-Q™, GearSet™, and Wirespeed™ are our trademarks. All other trademarks and trade names appearing in this Annual Report are owned by their respective holders.

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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

We have derived the following selected consolidated financial data as of December 31, 2012, 2011 and 2010 and for each of the years ended December 31, 2012, 2011 and 2010 from our consolidated financial statements and notes included in this Annual Report. The selected consolidated financial data as of December 31, 2009 and 2008 and for the years ended December 31, 2009 and 2008 have been derived from previously published audited consolidated financial statements not included in this Annual Report. We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles ("U.S. GAAP").

You should read the selected consolidated financial data together with "Item 5—Operating and Financial Review and Prospects" and our consolidated financial statements and related notes included elsewhere in this Annual Report. All references to "dollar," "dollars" or "\$" in this Annual Report are to the "U.S. dollar" or "U.S. dollars." All references to "NIS" are to the New Israeli Shekels.

Exchange Rate Information

The following table shows, for each of the months indicated the high and low exchange rates between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar and based upon the daily representative rate of exchange as published by the Bank of Israel:

Month	High (NIS)	Low (NIS)
April 2013 (through April 19)	3.633	3.618
March 2013	3.733	3.637
February 2013	3.708	3.682
January 2013	3.791	3.714
December 2012	3.835	3.726
November 2012	3.952	3.857
October 2012	3.895	3.792

On April 19, 2013 the daily representative rate of exchange between the NIS and U.S. dollar as published by the Bank of Israel was NIS 3.629 to \$1.00.

The following table shows, for each of the periods indicated, the average exchange rate between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar, calculated based on the average of the representative rate of exchange on the last day of each month during the relevant period as published by the Bank of Israel:

Year	Average (NIS)
2013 (through April 19)	3.693
2012	3.858
2011	3.582
2010	3.732
2009	3.927
2008	3.568

The effect of exchange rate fluctuations on our business and operations is discussed in "Item 5.A—Operating and Financial Review and Prospects—Operating Results—Impact of Inflation and Foreign Currency Fluctuations."

B.
CAPITALIZATION
AND
INDEBTEDNESS

Not applicable.

C.
REASONS
FOR THE
OFFER
AND USE
OF
PROCEEDS

Not applicable.

D.
RISK
FACTORS

Our business, operating results and financial condition could be seriously harmed due to any of the following risks, among others. If we do not successfully address the risks to which we are subject, we could experience a material adverse effect on our business, results of operations and financial condition and our share price may decline. We cannot assure you that we will successfully address any of these risks.

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Risks Related to Our Business and Our Industry

We have a history of net losses and may not achieve or sustain profitability in the future.

Although in 2010 we generated net income, in the years 2012, 2011 and 2009 we incurred losses of \$6 million, \$1.9 million and \$2.6 million, respectively. We may not be profitable in the future, which could materially affect our cash and liquidity and could adversely affect the value and market price of our shares.

The general slowdown in the telecommunications industry, including in the sectors of the industry that we target (primarily 3G and 4G cellular and triple-play networks), materially and adversely affected our revenues and results of operations in 2012. A continued slowdown would further materially and adversely affect our revenues and results of operations.

Our future success is dependent upon the continued growth of the telecommunications industry as well as the specific sectors that we target, which currently include 3G and 4G cellular and triple-play networks. A global slowdown in the telecommunications industry had an adverse impact on our business in the first half of 2012. The global telecommunications industry, as well as the various sectors within the industry, is evolving rapidly, and it is difficult to predict its potential growth rate or future trends in technology development. The deregulation, privatization and economic globalization of the worldwide telecommunications market that have resulted in increased competition and escalating demand for new technologies and services may not continue in a manner favorable to us or our business strategies. In addition, the growth in demand for Internet and data services and the resulting need for high speed or enhanced telecommunications equipment may not continue at its current rate or at all.

Our future success depends upon the increased utilization of our monitoring solutions by next-generation network operators and telecommunications equipment vendors. Industry-wide network equipment and infrastructure development driving the demand for our products and services was delayed during 2012 by a variety of factors and may further be delayed or prevented in 2013 by a variety of factors, including costs, regulatory obstacles or the lack of, or reduction in, consumer demand for advanced telecommunications products and services. Telecommunications equipment vendors and network operators may not develop new technology or enhance current technology. Further, any such new technology or enhancements may not lead to greater demand for our products.

During 2012, developments in the communications industry, such as the impact of general global economic conditions, industry consolidation, emergence of new competitors, commoditization of voice services and changes in the regulatory environment, had a material adverse effect on our existing and/or potential customers, and may continue to have such an effect in the future. In the past, these conditions reduced the high growth rates that the communications industry had previously experienced, and caused the market value, financial results, prospects and capital spending levels of many communications companies to decline. During 2012, the telecommunications industry experienced significant financial pressures that caused many in the industry to cut expenses and limit investment in capital intensive projects, and in some cases, led to restructurings. Although we are unable to determine what the full effects of the recent economic downturn will be, it has led, mainly during the first half of 2012, and may continue to lead to significant adverse consequences for our customers and our business.

During adverse conditions in the business environment for telecommunications companies, service providers often need to control operating expenses and capital investment budgets, which can affect our business. For example, the recent business climate for communication companies resulted in slowed customer buying decisions and price pressures that increased pressure on our ability to generate revenue. During 2012, these adverse market conditions had a negative impact on our business by decreasing new customer engagements, as well as by decreasing the level of discretionary spending under contracts with existing customers. In addition, the slowdown in the buying decisions of service providers has extended our sales cycle period and limited our ability to forecast our flow of new contracts. In

addition, weakness in the end-user market could negatively affect the cash flow of our distributors and resellers who could, in turn, delay paying their obligations to us. This increased our credit risk exposure and caused delays in our recognition of revenues on future sales to these customers. During 2012, these events harmed our business, operating results and financial condition. Further deterioration could materially and adversely affect our business, operating results and financial condition.

Recent and future economic conditions, including turmoil in the financial and credit markets, may adversely affect our business.

The recent economic and credit environment had a significant negative impact on business around the world. The impact of these conditions on the technology industry and our major customers has been quite severe. Conditions may continue to be depressed, or may be subject to further deterioration which could lead to a further reduction in consumer and customer spending overall, which could have an adverse impact on sales of our products. A disruption in the ability of our significant customers to access liquidity could cause serious disruptions or an overall deterioration of their businesses, which could lead to a significant reduction in their orders of our products and the inability or failure on their part, to meet their payment obligations to us, any of which could have a material adverse effect on our results of operations and liquidity. In addition, any disruption in the ability of customers to access liquidity could lead customers to request longer payment terms from us or long-term financing of their purchases from us. If we are unable to grant extended payment terms when requested by customers, our sales could decrease. Granting extended payment terms or a significant adverse change in a customer's financial and/or credit position, would have an immediate negative effect on our cash balance, and could require us to assume greater credit risk relating to that customer's receivables, or could limit our ability to collect receivables related to purchases by that customer. As a result, we may have to defer recognition of revenues, our reserves for doubtful accounts and write-offs of accounts receivable may increase and our losses may increase.

Our freedom to operate our business is limited as a result of certain restrictive covenants contained in our credit facility with the First International Bank of Israel, one of which we currently do not comply with.

In September 2012, we secured a short-term line of credit of \$1.5 million from the First International Bank of Israel. In order to secure our obligations to the bank, we pledged and granted to the bank a first priority floating charge on all of our assets and a first priority fixed charge on certain other assets (namely, rights for uncalled and/or unpaid share capital, including goodwill rights, and rights for insurance). We refer to the agreement relating to such charges as the Pledge. The Pledge contains a number of customary restrictive terms and covenants that limit our operating flexibility, such as (1) limitations on the creation of additional liens, and on the sale or transfer of certain of our assets, and (2) the ability of the bank to accelerate repayment in certain events, such as breach of covenants, liquidation, or a reduction in Messrs. Zohar Zisapel's and Yehuda Zisapel's joint ownership of the Company below 30%. The Pledge's restrictive terms and covenants may hinder our future operations or the manner in which we operate our business, which could have a material adverse effect on our business, financial condition or results of operations. One of the covenants we undertook was that our shareholder's equity, as reflected in our reported financial statements, would not be less than 32% of our total assets as reflected in the applicable balance sheet. As of December 31, 2012, we failed to meet the requirements of this covenant. The bank requested that we rectify the situation, and agreed to provide us with a cure period until July 15, 2013. We may fail to cure such breach and the bank may demand that we immediately repay the \$1.5 million, which will create a substantial burden on our cash balances and harm our ongoing operation.

Our projected cash flows may not be sufficient to meet our obligations.

If our cash flow does not meet or exceed our current projections, then our ability to pay our obligations could be materially impaired. We believe that our existing capital resources and cash flows from operations will be adequate to satisfy our expected liquidity requirements to meet our operating obligations, as they come due at least through the next twelve months. However, if our actual sales and spending differ materially from our projections, we may be required to raise capital, borrow additional funds or reduce discretionary spending in order to provide the required liquidity. We cannot assure you that our business will generate sufficient cash flows or that future capital raising or borrowings will be available to us in amounts and on terms sufficient to enable us to fund our liquidity needs. Our ability to continue as a going concern is substantially dependent on the successful execution of our sales and spending projections.

As noted above, although in 2010 we generated net income, in 2012, 2011 and in the years prior to 2010, we generated significant losses attributable to our operations. We have managed our liquidity during this time through a series of cost reduction initiatives, expansion of our sales into new markets, private placement transactions, a bank credit line, shareholder loans and a venture capital loan. While we believe that our existing capital resources and cash flows from operations will be adequate to satisfy our expected liquidity requirements at least through the next twelve months, there is no assurance that, if required, we will be able to raise additional capital or reduce discretionary spending to provide the required liquidity in order to continue as a going concern.

We have a history of quarterly fluctuations and unpredictability in our results of operations and expect these fluctuations to continue. This may cause our share price to fluctuate and/or to decline.

In 2012, we experienced, and expect to experience in the future, significant fluctuations in our quarterly results of operations. Factors that may contribute to fluctuations in our quarterly results of operations include:

- the variation in size and timing of individual purchases by our customers;
- the absence of long-term customer purchase contracts;
- seasonal factors that may affect capital spending by customers, such as the varying fiscal year-ends of customers and the reduction in business during the summer months, particularly in Europe;
- the relatively long sales cycles for our products;
- the request for longer payment terms from us or long-term financing of customers' purchases from us, as well as additional conditions tied to such payment terms;
- competitive conditions in our markets;
- the timing of the introduction and market acceptance of new products or product enhancements by us and by our customers, competitors and suppliers;
- changes in the level of operating expenses relative to revenues;
- product quality problems;
- supply interruptions;
- changes in global or regional economic conditions or in the telecommunications industry;
- delays in or cancellation of projects by customers;
- changes in the mix of products sold;
- the size and timing of approval of grants from the Government of Israel; and
- foreign currency exchange rates.

Our costs of sales consist of variable costs, which include hardware production, packaging, royalties to the Chief Scientist, license fees paid to third parties and import taxes, and of fixed costs which include facilities' payments, employees' salaries and related costs and overhead expenses. The majority of our costs of sales is relatively fixed, and the costs are determined based on our anticipated revenue. We believe, therefore, that period-to-period comparisons of our operating results may not be a reliable indication of future performance.

Our revenues in any period generally have been, and may continue to be, derived from a relatively small number of orders with relatively high average revenues per order. Therefore, the loss of any order or a delay in closing a transaction could have a more significant impact on our quarterly revenues and results of operations, than on those of companies with relatively high volumes of sales or low revenues per order. Our products generally are shipped within 15 to 30 days after orders are received, however revenue recognition is often deferred. Although we had a substantial backlog of orders at the end of 2012, this has not always been the case in the past and there is no assurance that this will continue to be the situation in future quarters.

We may experience a delay in generating or recognizing revenues for a number of reasons and based on revenue recognition accounting requirements. While we are usually able to ship orders within 15-30 days of a customer's order, in order to recognize revenue from an order, we often need to pass customer acceptance, which may take on average 6 to 12 months. Therefore, a major part of the revenue of a fiscal quarter is derived from the backlog of shipped orders and generally is not tied to the date of a customer's order or the shipment date.

Our revenues for a particular period may also be difficult to predict and may be affected if we experience a non-linear (back-end loaded) sales pattern during the period. We generally experience significantly higher levels of sales towards the end of a period, as a result of customers submitting their orders late in the period. Such non-linearity in shipments can increase costs, as irregular shipment patterns result in periods of underutilized capacity and periods when overtime expenses may be incurred, and also lead to additional costs associated with inventory planning and management. Furthermore, orders received towards the end of the period may not ship within the period due to our manufacturing lead times. These orders are booked within the quarter, but only recognized as revenue at a later stage.

If our revenues in any quarter remain level or decline in comparison to any prior quarter, our financial results could be materially adversely affected. In addition, if we do not reduce our expenses in a timely manner in response to level or declining revenues, our financial results for that quarter could be materially adversely affected.

Since 2010, the relative portion of medium-to-large sized deals started to increase. This trend continued with greater vigor in 2011 and 2012. As a result, payment terms became longer by an average of 2 months, the deployment process became longer and more complex and our right to collect payment more often became subject to certain conditions, extending the time that elapsed between the date of an initial sale and full revenue recognition and collection.

Due to the factors described above, as well as other unanticipated factors, in future quarters our results of operations could fail to meet the expectations of public market analysts or investors. If this occurs, the price of our ordinary shares may fall, as was the case in 2012.

We expect our gross margins to vary over time and our recent level of gross margins may not be sustainable or improved, which may have a material adverse effect on our future profitability.

Our recent level of gross margins may not be sustainable or improved and may be adversely affected by numerous factors, including:

- increased price competition;
- local sales taxes which may be incurred for direct sales;
- increased industry consolidation among our customers, which may lead to decreased demand for and downward pricing pressure on our products;
- changes in customer, geographic or product mix;
- our ability to reduce and control production costs;
- increases in material or labor costs;
- excess inventory and inventory holding costs;
- obsolescence charges;
- reductions in cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand;
- changes in distribution channels;
- losses on customer contracts; and
- increased warranty costs.

Further deterioration in gross margins, due to these or other factors, may have a material adverse effect on our results of operations.

The market for our products is characterized by changing technology, requirements, standards and products, and we may be materially adversely affected if we do not respond promptly and effectively, to such changes.

The telecommunications market for our products is characterized by rapidly changing technology, changing customer requirements, evolving industry standards and frequent new product introductions, certain changes of which could reduce the market for our products or require us to develop new products. For example, the LTE (Long Term Evolution) network required us to develop a new product which was launched in 2011, our Omni-Q for LTE networks, in order to keep current with customer requirements.

New or enhanced telecommunications and data communications-related products developed by other companies could be incompatible with our products. Therefore, our timely access to information concerning, and our ability to anticipate, changes in technology and customer requirements and the emergence of new industry standards, as well as our ability to develop, manufacture and market new and enhanced products successfully and on a timely basis, will be significant factors in our ability to remain competitive. For example, many of our strategic initiatives and investments are aimed at meeting the requirements of application providers of 3G and LTE cellular and triple-play networks. If networking evolves toward greater emphasis on application providers, we believe that we have positioned ourselves well relative to our key competitors. If networking does not evolve toward greater emphasis on application providers, however, our initiatives and investments in this area may be of no or limited value. As a result, we cannot quantify the impact of new product introductions on our future operations.

Our sales derived from emerging market countries may be materially adversely affected by economic, regulatory and political developments in those countries.

We generate sales from various emerging market countries. As sales from these countries represent a significant portion of our total sales, and as these countries represent a significant portion of our expected growth, economic or political turmoil in these countries could materially adversely affect our sales and results of operations. During 2012, such regulatory limitations delayed our ability to recognize revenue from certain customers. Our investments in emerging market countries may also be subject to risks and uncertainties, including unfavorable taxation treatment, exchange controls, challenges in protecting our intellectual property rights, nationalization, inflation, currency fluctuations, or the absence of, or unexpected changes in, regulation as well as other unforeseeable operational risks.

Our growing international presence exposes us to risks associated with varied and changing political, cultural, legal and economic conditions worldwide.

We are affected by risks associated with conducting business internationally. We maintain development facilities in Israel, and have operations in North America, Europe, Latin America and Asia. We obtain significant revenues from customers in Latin America and Asia and our strategy is to continue to broaden and expand into those markets. Conducting business internationally exposes us to certain risks inherent in doing business in international markets, including:

- legal and cultural differences in the conduct of business;
- difficulties in staffing and managing foreign operations;
- longer payment cycles;
- difficulties in collecting accounts receivable and withholding taxes that limit the repatriation of earnings;
- difficulties in complying with varied legal and regulatory requirements across jurisdictions, including additional labor laws, particularly in Brazil;
- political instability;
-

variations in effective income tax rates among countries where we conduct business;

- fluctuations in foreign currency exchange rates; and
- laws and business practices favoring local competitors;

One or more of these factors could have a material adverse effect on our international operations, which could harm our results of operations and financial condition.

Our inventory may become obsolete or unusable.

We make advance purchases of various component parts in relatively large quantities to ensure that we have an adequate and readily available supply. Our failure to accurately project our needs for these components and the demand for our products that incorporate them, or changes in our business strategy or technology that reduce our need for these components, could result in these components becoming obsolete prior to their intended use or otherwise unusable in our business. This would result in a write-off of inventories for these components. In addition, a substantial portion of our inventory is located at customers as it has not yet been accepted in accordance with the terms of their orders and therefore, has not yet been recognized as revenue, making the control of such inventory more difficult.

Any reversal or slowdown in deregulation of telecommunications markets could materially harm the markets for our products.

Future growth in the markets for our products will depend, in part, on the continued privatization, deregulation and the restructuring of telecommunications markets worldwide, as the demand for our products is generally higher when a competitive environment exists. Any reversal or slowdown in the pace of this privatization, deregulation or restructuring could materially harm the markets for our products. Moreover, the consequences of deregulation are subject to many uncertainties, including judicial and administrative proceedings that affect the pace at which the changes contemplated by deregulation occur, and other regulatory, economic and political factors. Furthermore, the uncertainties associated with deregulation have in the past, and could in the future, cause our customers to delay purchasing decisions pending the resolution of these uncertainties.

Many of our customers require a lengthy, detailed and comprehensive evaluation process before they order our products. Our sales process has been subject to delays that have significantly decreased our revenues and which could result in the eventual cancellations of some sale opportunities.

We derive substantially all of our revenues from the sale of products and related services for telecommunications service providers. The purchase of our products represents a relatively significant capital expenditure for our customers. As a result, our products generally undergo a lengthy evaluation process before we can sell them. In recent years, our customers have been conducting a more stringent and detailed evaluation of our products and decisions are subject to additional levels of internal review. This trend has intensified recently as part of the recent economic environment. As a result, the evaluation process has significantly lengthened. This evaluation process generally takes between 3 to 6 months for small transactions, and between 9 to 18 months for large transactions. The following factors, among others, affect the length of the approval process:

- the time involved for our customers to determine and announce their specifications;
- the time required for our customers to process approvals for purchasing decisions;
- the complexity of the products involved;
- the technological priorities and budgets of our customers; and
- the need for our customers to obtain or comply with any required regulatory approvals.

If customers continue to delay project approval, delays lengthen further, or such continued delays result in the eventual cancellation of any sale opportunities, it would harm our business and results of operations.

Our visibility of a portion of our future sales is limited due to the short lead time of customer orders.

As a result of the short lead time for some firm purchase orders that we receive from time to time, which usually do not require customer acceptance, we are unable to accurately forecast future revenues from these product sales. As a result, especially with respect to purchase orders of significant amounts, even dramatic fluctuations in revenue (whether increase or decrease) might not be detected until the very end of a financial quarter, which may not enable us to monitor costs in a timely manner to compensate for such fluctuations.

We may undertake further reorganizations, which may adversely impact our operations, and we may not realize all of the anticipated benefits of our prior or any future reorganizations.

We continue to reorganize and transform our business to realign resources and achieve desired cost savings in an increasingly competitive market. Although during 2010 and 2011 we increased our work force, during 2009 and 2012 we undertook a series of reorganizations of our operations involving, among other things, the reduction of our workforce. If we continue to reduce our workforce in the future, we may incur additional reorganization and related expenses, which could have a material adverse effect on our business, financial condition or results of operations.

We have based our reorganization efforts on certain assumptions regarding the cost structure of our businesses. Our assumptions may or may not be correct, and we may also determine that further reorganizations will be needed in the future. We therefore cannot assure you that we will realize all of the anticipated benefits of the reorganizations or that we will not further reduce or otherwise adjust our workforce or exit, or dispose of, certain businesses. Any decision by management to further limit investment or to exit or dispose of businesses may result in the recording of additional reorganization charges, and might also adversely affect our ability to generate revenues from our business. As a result, the costs actually incurred in connection with the reorganization efforts may be higher than originally planned and may not lead to the anticipated cost savings and/or improved results.

In addition, employees, whether or not directly affected by reorganizations, may seek future employment with our business partners, customers or competitors. We cannot assure you that the confidential nature of our proprietary information will not be compromised by any such employees who terminate their employment with us. Further, we believe that our future success will depend in large part upon our ability to attract, incentivize and retain highly skilled personnel. We may have difficulty attracting and retaining such personnel as a result of a perceived risk of future workforce reductions.

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

We currently have non-competition agreements with our key and other employees in Israel. These agreements prohibit those employees, while they work for us and for a specified length of time after they cease to work for us, from directly competing with us or working for our competitors. Under current U.S. and Israeli law, we may not be able to enforce these non-competition agreements. If we are unable to enforce any of these agreements, competitors that employ our former employees could benefit from the expertise our former employees gained while working for us. In addition, we have non-competition agreements with employees outside of Israel, and we cannot guarantee that such agreements are enforceable under applicable law.

Our business could be harmed if we were to lose the services of one or more members of our senior management team, or if we are unable to attract and retain qualified personnel.

Our future growth and success depends to a significant extent upon the continuing services of our executive officers and other key employees. We do not have long-term employment agreements with any of our employees. Competition for qualified management and other high-level telecommunications industry personnel is intense, and we may not be successful in attracting and retaining qualified personnel. If we lose the services of any key employees, we may not be able to manage our business successfully or to achieve our business objectives.

Our success also depends on our ability to identify, attract and retain qualified technical, sales, finance and management personnel. We have experienced, and may continue to experience, difficulties in hiring and retaining candidates with appropriate qualifications. If we do not succeed in hiring and retaining candidates with appropriate qualifications, our revenues and product development efforts could be harmed.

We may lose significant market share as a result of intense competition in the markets for our existing and future products.

Many companies compete with us in the market for network testing and service monitoring solutions. We expect that competition will increase in the future, both with respect to products that we currently offer and products that we are developing. Moreover, manufacturers of data communications and telecommunications equipment, which are current and potential customers of ours, may in the future incorporate into their products capabilities similar to ours, which would reduce the demand for our products. In addition, affiliates of ours that currently provide services to us may, in the future, compete with us.

Many of our existing and potential competitors have substantially greater resources, including financial, technological, engineering, manufacturing and marketing and distribution capabilities, and several of them may enjoy greater market recognition than us. We may not be able to compete effectively with our competitors. A failure to do so could adversely affect our revenues and profitability.

We are dependent upon the success of distributors who are under no obligation to distribute our products.

We are dependent upon our distributors for their active marketing and sales efforts for the distribution of our products. Outside of North America, Brazil, Singapore, India and China, many of our distributors are the only entities engaged in the distribution of our products in their respective geographical areas. Typically, arrangements with our distributors do not prevent such distributors from distributing competing products, or require them to distribute our products in the future and, therefore, our distributors may not give a high priority to marketing and supporting our products. Additionally, our results of operations could be materially adversely affected by changes in the financial situation, business or marketing strategies of our distributors. Any such changes could occur suddenly and rapidly.

We may lose customers and/or distributors on whom we currently depend and we may not succeed in developing new distribution channels.

Our seven largest distributors accounted for approximately 38.51% of our sales in 2012, 43.9% of our sales in 2011 and 41.8% of our sales in 2010. In 2012, no individual distributor accounted for more than 10% of the total respective consolidated revenues. If we terminate or lose any of our distributors or if they downsize significantly, we may not be successful in replacing them on a timely basis, or at all. Any changes in our distribution and sales channels, particularly the loss of a major distributor or our inability to establish effective distribution and sales channels for new products, will impact our ability to sell our products and result in a loss of revenues.

Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that may have an adverse effect on our business.

Large telecommunications providers have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may require us to develop additional features and may impose penalties on us for failure to deliver such features on a timely basis, or failure to meet performance standards. As we seek to sell more products to large service providers, we may be required to agree to these less advantageous terms and conditions, which may decrease our revenues and/or increase the time it takes to convert orders into revenues, resulting in an adverse effect on our results of operations.

The complexity and scope of the solutions 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 such projects. These risks include failure to fully integrate our products into the service provider's network with third party products and complex environments, and our dependence on subcontractors and partners for the successful and timely completion of such projects. Failure to complete a larger project successfully could expose us to potential contractual penalties, claims for breach of contract and in extreme cases, to cancellation of the entire project, or increase the difficulty in collecting payment and recognizing revenues from such project.

We could be subject to claims under our warranties and extended maintenance agreements and product recalls, which could be very expensive and harm our financial condition.

Products as complex as ours sometimes contain undetected errors. These errors can cause delays in product introductions or require design modifications. In addition, we are dependent on other suppliers for key components that are incorporated in our products. Defects in systems in which our products are deployed, whether resulting from faults in our products or products supplied by others, due to faulty installation or any other cause, may result in customer dissatisfaction, product returns and, potentially, product liability claims being filed against us. Our warranties permit customers to return defective products for repair. The warranty period is mostly for one year but could be extended either in the initial purchase of our product or after the initial warranty period ends ("extended maintenance agreements"). During the past few years, customer returns have not been substantial. Any failure of a system in which our products are deployed (whether or not our products are the cause), any product recall or product liability claims with any associated negative publicity, could result in the loss of, or delay in, market acceptance of our products and harm to our business. In addition, under the warranty and extended maintenance agreements we need to meet certain service levels and if we fail to meet them we may be exposed to penalties.

We incorporate open source technology in our products, which may expose us to liability and have a material impact on our product development and sales.

Some of our products utilize open source technologies. These technologies are licensed to us on varying license structures. These licenses pose a potential risk to products in the event they are inappropriately integrated. In the event that we have not, or do not in the future, properly integrate software that is subject to such licenses into our products, we may be required to disclose our own source code to the public, which could enable our competitors to eliminate any technological advantage that our products may have over theirs. Any such requirement to disclose our source code or other confidential information related to our products could, therefore, materially adversely affect our competitive advantage and impact our business results of operations and financial condition.

We depend on limited sources for key components and if we are unable to obtain these components when needed, we will experience delays in manufacturing our products.

We currently obtain key components for our products from either a single supplier or a limited number of suppliers. We do not have long-term supply contracts with any of our existing suppliers. This presents the following risks:

- Delays in delivery or shortages in components could interrupt and delay manufacturing and result in cancellations of orders for our products.
- Suppliers could increase component prices significantly and with immediate effect.

- We may not be able to locate alternative sources for product components.
- Suppliers could discontinue the manufacture or supply of components used in our products. This may require us to modify our products, which may cause delays in product shipments, increased manufacturing costs and increased product prices.
- We may be required to hold more inventory than would be immediately required in order to avoid problems from shortages or discontinuance.

We have experienced delays and shortages in the supply of components on more than one occasion in the past. This resulted in delays in our delivering products to our customers.

We depend on a limited number of independent manufacturers, which reduces our ability to control our manufacturing process.

We rely on a limited number of independent manufacturers, some of which are small, privately held companies, to provide certain assembly services to our specifications. We do not have any long-term supply agreements with any third-party manufacturers. If our access to such assembly services is reduced or interrupted, our business, financial condition and results of operations could be adversely affected until we are able to establish sufficient assembly services from alternative sources. Alternative manufacturing sources may not be able to meet our future requirements, and existing or alternative sources may not continue to be available to us at favorable prices.

New regulations related to conflict minerals may force us to incur additional expenses and may damage our relationship with certain customers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of certain minerals and derivatives referred to as “conflict minerals” which may originate from the conflict zones of the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC established new annual disclosure and reporting requirements for those companies who use “conflict” minerals in their products, whether or not the products are manufactured by third parties. These new requirements will require due diligence efforts for the 2013 calendar year, with initial disclosure requirements beginning in May 2014. We are currently examining whether we will be subject to these new disclosure requirements, as the types of minerals covered by these rules are present in electronic devices, and consequently we believe we may be subject to these new disclosure requirements.

If we are subject to these new requirements, we will incur additional costs associated with complying with the disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. As these new requirements are implemented, they could affect the pricing, sourcing and availability of minerals used in the manufacture of components in our devices, and in turn could affect the costs and availability of such components. Our supply chain is complex and we may be unable to verify the origins for all metals used in our products. We may also encounter challenges with our customers and stakeholders if we are unable to certify that our products are conflict free.

Our proprietary technology is difficult to protect, and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

Our success and ability to compete depend in large part upon protecting our proprietary technology. We rely upon a combination of contractual rights, software licenses, trade secrets, copyrights, nondisclosure agreements and technical measures to establish and protect our intellectual property rights in our products and technologies. In addition, we sometimes enter into non-competition, non-disclosure and confidentiality agreements with our employees, distributors, sales representatives and manufacturers’ representatives and certain suppliers with access to sensitive information. However, we have no registered patents, and these measures may not be adequate to protect our technology from third-party infringement. Additionally, effective trademark, patent and trade secret protection may not be available in every country in which we offer, or intend to offer, our products.

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 growth strategy is to selectively pursue partnerships and acquisitions that provide us access to complementary technologies and accelerate our penetration into new markets. 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. Acquired businesses, technologies or joint ventures may not be successfully integrated with our products and operations. We may not realize the intended benefits of any acquisition, investment or joint venture and we may incur future losses from any acquisition, investment or joint venture.

In addition, acquisitions could result in, among other things:

- 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 we implement our growth strategy by acquiring other businesses, and this disrupts our operations, our business may suffer.

Because we received grants from the Israeli Office of the Chief Scientist, we are subject to ongoing restrictions.

We received royalty-bearing grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor (the "Chief Scientist"), for research and development programs that meet specified criteria. In addition to our obligation to pay to the Chief Scientist royalties on revenues from products developed pursuant such programs or deriving therefrom (and related services), our ability to transfer such resulting know-how, especially outside of Israel, is limited, regardless of whether the royalties were fully paid. Any non-Israeli citizen, resident or entity that, among other things, (i) becomes a holder of 5% or more of our share capital or voting rights, (ii) is entitled to appoint one or more of our directors or our chief executive officer, or (iii) serves as one of our directors or as our chief executive officer (including holders of 25% or more of the voting power, equity or the right to nominate directors in such direct holder, if applicable), is required to notify the Chief Scientist of the same and to undertake to the Chief Scientist to observe the law governing the grant programs of the Chief Scientist, the principal restrictions of which are the transferability limits described above. For more information, see "Item 4.B—Information on the Company—Business Overview—Israeli Office of the Chief Scientist."

We may be subject to litigation and other claims, including, without limitation, infringement claims or claims that we have violated intellectual property rights, which could seriously harm our business.

Third parties may from time to time assert against us infringement claims or claims that we have violated a patent or infringed a copyright, trademark or other proprietary right belonging to them. If such infringement were found to exist, we might be required to modify our products or intellectual property or to obtain a license or right to use such technology or intellectual property. Any infringement claim, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Additionally, in May 2010, we received a notice from the Chief Scientist regarding alleged miscalculations in the amount of royalties paid by us to the Chief Scientist for the years 1992 through 2009 and the basis revenues of which the Company has to pay royalties. We believe that all royalties due to the Chief Scientist from the sale of products developed with funding provided by the Chief Scientist during such years were properly paid or were otherwise

accrued as of December 31, 2012. During 2011 we reviewed with the Chief Scientist these alleged miscalculation differences and now await further instructions. Currently we are unable to assess the merits of the aforesaid arguments raised by the Chief Scientist. If such royalties were not properly paid or otherwise accrued, any such differences could result in the expenditure of significant financial resources.

Yehuda Zisapel and Zohar Zisapel beneficially own, in aggregate, approximately 41% of our ordinary shares and, therefore, have significant influence over the outcome of matters requiring shareholder approval, including the election of directors.

As of April 19, 2013, Yehuda Zisapel and Zohar Zisapel (the Chairman of our Board of Directors), who are brothers, may be deemed to beneficially own an aggregate of 2,748,213 ordinary shares, including options and warrants exercisable for 178,986 ordinary shares that are exercisable within 60 days of April 19, 2013, representing approximately 41% of our outstanding ordinary shares. As a result, despite the fact that each one of them, to our knowledge, operates independently from the other with respect to his respective shareholding of our shares, Yehuda Zisapel and Zohar Zisapel have significant influence over the outcome of various actions that require shareholder approval, including the election of our directors. In addition, Yehuda Zisapel and Zohar Zisapel may be able to delay or prevent a transaction in which shareholders might receive a premium over the prevailing market price for their shares and prevent changes in control or in management.

We engage in transactions, and may compete with, companies controlled by Yehuda Zisapel and Zohar Zisapel, which may result in potential conflicts.

We are engaged in, and expect to continue to be engaged in, numerous transactions with companies controlled by Yehuda Zisapel and Zohar Zisapel. We believe that such transactions are beneficial to us and are generally conducted upon terms that are no less favorable to us than would be available from unaffiliated third parties. Nevertheless, these transactions may result in a conflict of interest between what is best for us and the interests of the other parties in such transactions. In addition, several products of such affiliated companies may be used in place of our products, and it is possible that direct competition between us and one or more of such affiliated companies may develop in the future. Moreover, opportunities to develop, manufacture, or sell new products (or otherwise enter new fields) may arise in the future and may be pursued by one or more affiliated companies instead of with us. This could materially adversely affect our business and results of operations.

If we fail to adapt appropriately to the challenges associated with operating internationally, the expected growth of our business may be impeded and our operating results may be affected.

While we are headquartered in Israel, approximately 91% of our sales in 2012, 98% of our sales in 2011 and 95% of our sales in 2010 were generated outside of Israel, including in North America, Europe, Asia, South America and Australia. Our international sales will be limited if we cannot establish and maintain relationships with international distributors, set up additional foreign operations, expand international sales channel management, hire additional personnel, develop relationships with international service providers and operate adequate after-sales support internationally.

Even if we are able to successfully expand our international operations, we may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

- challenges in staffing and managing foreign operations due to the limited number of qualified candidates, employment laws and business practices in foreign countries, any of which could increase the cost and reduce the efficiency of operating in foreign countries;
- our inability to comply with import/export, environmental and other trade compliance and other regulations of the countries in which we do business, together with unexpected changes in such regulations;
- insufficient measures to ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future;

- our failure to adhere to laws, regulations and contractual obligations relating to customer contracts in various countries;
- our inability to maintain a competitive list of distributors for indirect sales;
- tariffs and other trade barriers;
- economic instability in foreign markets;
- wars, acts of terrorism and political unrest;