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**

OR

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

For the fiscal year ended December 31, 2007

OR

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

OR

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 45240
Israel
(Address of principal executive offices)

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

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

Ordinary shares
NIS 0.10 par value per share

Title of Class

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 December 31, 2007: 22,008,249 ordinary shares, NIS 0.1 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 o   Accelerated filer x   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 suggest otherwise, the terms “Allot,” “Company,” “we,” “us” or “ours” refer to Allot 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 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 auction-rate securities and their expected impact on our liquidity;
- statements regarding the price and market liquidity of our ordinary shares;
- statements as to our ability to retain our current suppliers and subcontractors;
- statements regarding our future performance, sales, gross margins, expenses (including stock-based compensation expenses) and cost of revenues; and
- statements regarding whether we will be classified as a passive foreign investment company.

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 Investment 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—Industry Background,” which contains information obtained from independent industry sources. 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: Key Information—Risk Factors” and elsewhere in this annual report.

In addition, statements that use the terms “believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate” and 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, 2005, 2006 and 2007 and the consolidated balance sheet data as of December 31, 2006 and 2007 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, 2003 and 2004 and the consolidated balance sheet data as of December 31, 2003, 2004 and 2005 have been derived from our audited consolidated financial statements which are not included in this annual report.

	Year ended December 31,				
	2003	2004	2005	2006	2007
	(in thousands of U.S. dollars, except per share and share data)				
Consolidated Statements of Operations:					
Revenues:					
Products	$ 13,122	$ 14,638	$ 18,498	$ 28,756	$ 25,073
Services	1,653	3,447	4,474	5,388	7,429
Total revenues	14,775	18,085	22,972	34,144	32,502
Cost of revenues(1):					
Products	3,229	3,942	4,481	6,435	6,603
Services	362	679	938	1,162	1,416
Total cost of revenues	3,591	4,621	5,419	7,597	8,019
Gross profit	11,184	13,464	17,553	26,547	24,483
Operating expenses:					
Research and development, gross	4,053	4,851	6,652	9,340	11,755
Less royalty-bearing participation	1,094	894	727	1,811	2,371
Research and development, net(1)	2,959	3,957	5,925	7,529	9,384
Sales and marketing(1)	8,164	10,104	11,887	15,457	18,081
General and administrative(1)	1,832	2,081	2,380	3,464	5,583
Impairment of intangible assets	—	366	—	—	—
Total operating expenses	12,955	16,508	20,192	26,450	33,048
Operating income (loss)	(1,771)	(3,044)	(2,639)	97	(8,565)
Financing and other income (expenses), net	(507)	(241)	45	630	(845)
Income (loss) before income tax expenses (benefit)	(2,278)	(3,285)	(2,594)	727	(9,410)
Income tax expenses (benefit)	2	3	(218)	111	530
Net income (loss)	$ (2,280)	$ (3,288)	$ (2,376)	$ 616	$ (9,940)
Basic net earnings (loss) per share	$ (0.82)	$ (1.18)	$ (0.81)	$ 0.04	$ (0.46)
Diluted net earnings (loss) per share	$ (0.82)	$ (1.18)	$ (0.81)	$ 0.04	$ (0.46)
Weighted average number of shares used in computing basic net earnings (loss) per share	2,774,639	2,787,554	2,943,500	14,402,338	21,525,822
Weighted average number of shares used in computing diluted net earnings (loss) per share	2,774,639	2,787,554	2,943,500	16,423,227	21,525,822

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

	Year ended December 31,				
	2003	2004	2005	2006	2007
	(in thousands of U.S. dollars)				
Cost of revenues	$ —	$ —	$ —	$ 15	$ 48
Research and development expenses, net	22	17	12	157	230
Sales and marketing expenses	40	25	251	650	340
General and administrative expenses	235	116	42	539	743
Total	$ 297	$ 158	$ 305	$ 1,361	$ 1,361

	At December 31,				
	2003	2004	2005	2006	2007
	(in thousands of U.S. dollars)				
Consolidated balance sheet data:					
Cash and cash equivalents	$ 3,631	$ 4,095	$ 3,677	$ 7,117	$ 28,101
Marketable securities	—	4,846	4,581	76,114	42,614
Working capital	2,481	6,640	4,274	75,182	37,225
Total assets	10,771	17,167	17,591	99,506	94,655
Total liabilities	7,326	8,974	11,465	15,319	17,470
Accumulated deficit	(32,220)	(35,508)	(37,884)	(37,268)	(47,208)
Total shareholders’ equity	3,446	8,193	6,126	84,187	77,185

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, may incur future losses and may not achieve profitability.

We have incurred net losses in each fiscal year since we commenced operations in 1997 and through 2007, other than 2006. We had a net loss of $9.9 million in 2007 compared to net income of $0.6 million in 2006 and a net loss of $2.4 million in 2005. We can provide no assurance that we will be able to achieve profitability and we may incur losses in the next several years as we expand our sales and marketing activities and continue to invest in research and development. We may incur losses in the future and may not generate sufficient revenues in the future to achieve profitability.

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

We currently derive the substantial majority of our revenues from sales of our NetEnforcer traffic management system, NetXplorer network management application suite, the Service Gateway platform, and from maintenance and support contracts related to these products. In 2007, we commenced sales of our Service Gateway platform, which combines a powerful DPI engine and array of services into a fully integrated, carrier-class platform; however, sales of our Service Gateway to date have been limited and we can give no assurance that we will achieve widespread market acceptance for this platform. Accordingly, we currently expect that revenues from our NetEnforcer traffic management system and NetXplorer network management system will continue to account for a substantial portion of our revenues for the immediate future. As a result, any factor adversely affecting our ability to sell, or the pricing of or demand for, these products would severely harm our ability to generate 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. Our principal competitors are Cisco Systems, Inc., Sandvine Inc. and Arbor Network, Inc. (through its acquisition of Ellacoya Networks, Inc.) in the service provider market, including the segment of the largest service providers, referred to as Tier 1 carriers, and Blue Coat Systems, Inc. (through its acquisition of Packeteer Inc.) in the enterprise market. Our competitors have also identified the potential market opportunity of Tier 1 carriers and we therefore expect intensive competition in this segment in the future. We also compete with a number of smaller competitors such as CloudShield Technologies, Inc. and Procera Networks, Inc. and we compete indirectly with router and switch infrastructure companies with features that address some of the problems that our products address. We also face competition from companies that offer partial solutions addressing only one aspect 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. The entry of new competitors into our market 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 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.

The market for our products is still in its early stage and our growth may be harmed if carriers, cable operators or mobile operators and midsize service providers, do not adopt DPI solutions.

The market for DPI technology is still in its early stage. We believe that the Tier 1 carriers, as well as cable and mobile operators and midsize service providers, present a significant market opportunity and are an important element of our long term strategy, but they are still in the early stages of evaluating the benefits and applications of DPI technology. Carriers, cable operators, mobile operators and midsize service providers may decide that full visibility into their networks or highly granular control over content based applications is not critical to their business. They may also determine that certain applications, such as VoIP or video, can be adequately prioritized in their networks by using router and switch infrastructure products without the use of DPI technology. They may also, in some instances, face regulatory constraints that could change the characteristics of the markets. They may also seek an embedded DPI solution in capital equipment devices such as routers rather than the stand-alone solution offered by us. Furthermore, widespread adoption of our products by carriers, cable operators, mobile operators and midsize service providers may require that they migrate to a new business model based on offering subscriber and application-based tiered services and market these new services successfully to consumers. If they decide not to adopt DPI technology, our market opportunity would be reduced and our growth rate may be harmed.

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

Carriers are subject to government regulation in jurisdictions in which we sell our products. There are several bills pending before the U.S. Congress that would prohibit service providers from prioritizing applications from content providers who are prepared to pay for such service. To date, none of these bills has been adopted; however, some of these bills may still be raised for consideration and other jurisdictions in which we operate may adopt similar legislation. Advocates for the legislation claim that collecting premium fees from certain “preferred” customers would distort the market for Internet applications in favor of larger and better-funded content providers and would impact end users who purchased broadband access only to experience differing response times in interacting with various content providers. Opponents of the legislation 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 addition, the Federal Communications Commission has recently held hearings to discuss “net neutrality,” which is has been defined as service providers treating Internet content equally and not interfering with download speeds, regardless of the size or source of content. Demand from carriers 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.

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. Developments in routers and routing software could also significantly reduce demand for our products. 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 products and technology.

Demand for our products depends in part on the rate of adoption of bandwidth-intensive broadband applications, such as peer-to-peer (P2P), and latency-sensitive applications, such as voice-over-Internet protocol (VoIP), Internet video and online video gaming applications.

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. In addition to the general increase in applications delivered over broadband networks that require large amounts of bandwidth, such as P2P applications, demand for our products is driven particularly by the growth in applications which are highly sensitive to network delays and therefore require efficient network management. These applications include VoIP, Internet video and online video gaming applications. If the rapid growth in adoption of VoIP and in the popularity of Internet video and online video gaming applications does not continue, the demand for our products may not grow as anticipated.

We depend on third parties to market, sell, install, and provide initial technical support for our products.

We depend on third party channel partners, such as distributors, resellers, OEMs and system integrators, to market and sell our products to end-customers. 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 market and sell our products successfully to end-customers. If any significant channel partners fail, individually or in the aggregate, to perform as we expect, our sales may suffer. For example, our revenues in the first quarter of 2007 were lower than anticipated as a result of certain of our channel partners failing to purchase our products as we had expected. We also depend on our ability to maintain our relationships with existing channel partners and develop relationships in key markets with new channel partners. We cannot assure you that our channel partners will market our products effectively, receive and fulfill customer orders of 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 their operation and installation. 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.

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, they can be terminated by either party. We can give no assurance that these agreements will not be terminated upon proper notice and any such termination may adversely affect our profitability and results of operations.

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

We integrate various third-party solutions into our Service Gateway platform and may integrate or offer additional third-party solutions in the future. Sales of the Service Gateway platform 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.

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.

The length of our sales cycles to large service providers, including carriers, cable operators and mobile operators, is 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. As a result, we may invest significant time from initial contact with a large service provider until that end-customer decides to incorporate our products in its network. We may also expend significant resources attempting to persuade large service providers to incorporate our products into their networks without success. Even after deciding to purchase our products, initial network deployment of our products by a large service provider may last up to three years. 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 expense without generating any sales.

Carriers, especially in North America, may condition a purchase of our products upon our receipt of a certification that such products meet the Network Equipment Building System (NEBS) requirements.

Carriers, especially in North America, often require that products they purchase meet Network Equipment Building System (NEBS) certification requirements, which relate the reliability of telecommunications equipment. Our Service Gateway platform and NetEnforcer AC-1000 and AC-2500 are designed to meet NEBS certification requirements, but carriers may not choose to use our systems until we receive the certification.

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 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 and claims for breach of contract or increase the likelihood we have difficulty in collecting payment and recognizing revenues.

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

We will need to invest heavily in developing our DPI technology in order to keep pace with rapid changes in applications, increased broadband network speeds and with our competitors' efforts to advance their technology. Designers of broadband applications that our products are designed to 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 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. If we fail to address the needs of customers in particular geographic markets and if we fail to develop enhancements to our products in order to keep pace with advances in technology, our business and revenues will be adversely affected.

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

We currently depend on a single subcontractor, R.H. Electronics Ltd., to manufacture, assemble, test, package and provide hardware warranty support for all of our NetEnforcer traffic management systems, and another subcontractor, Flextronics (Israel) Ltd., a subsidiary of Flextronics, a global electronics manufacturing, services company, to provide similar services for our Service Gateway platform. In addition, our agreements with Flextronics (Israel) and R.H. Electronics requires them to procure and store key components for our products at their facilities. If either of them experiences delays, disruptions or quality control problems in manufacturing our products, or if we fail to effectively manage the relationship with them, shipments of products to our customers may be delayed and our ability to deliver products to customers could be materially adversely affected. Our agreements with Flextronics (Israel) and R.H. Electronics are automatically renewed annually for additional one-year terms. R.H. Electronics may elect not to renew our agreement with them by giving us at least 90 days prior notice to the expiration of any such term. Furthermore, R.H. Electronics may terminate our agreement with them at any time during the term upon 120 days prior notice. 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 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. Therefore, the loss of either R.H. Electronics or Flextronics (Israel) would adversely affect our sales and operating results, and harm our reputation.

The facilities of both R.H. Electronics and Flextronics (Israel) are located in northern Israel and are in range of rockets that were fired during 2006 from Lebanon into Israel. In the event that the facilities of either contractor are damaged as a result of hostile action, our ability to deliver products to customers could be materially adversely affected. See also "—Conditions in Israel could adversely affect our business, and —Our operations may be disrupted by the obligations of personnel to perform military service."

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.

Certain hardware components used in our products are obtained from single or limited sources. Since our systems 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. Such changes could be costly and result in lost sales. In particular, the central processing unit for out NetEnforcer AC-400 and our NetEnforcer AC-800 is from Intel Corporation, the network processor for our NetEnforcer AC-1000 and our NetEnforcer AC-2500 is from Hifn Inc., and the central processing unit for our Service Gateway – Omega Series is from Raza Microelectronics, Inc.

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. Our suppliers 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.

Unfavorable economic and market conditions may cause a slowdown in capital expenditures by telecommunications service providers and may lead to a decreased demand for our products. This may harm our business, financial condition and results of operations.

We are subject to the effects of general global, economic and market conditions and recent events in the financial market may have an impact on our business. In particular, many enterprises, telecommunications carriers and service providers may reduce their capital investments. Since 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 achieve profitability. Any future industry downturn may increase our inventories, decrease our revenues, result in additional pressure on the price of our products and prolong the time until we are paid, all of which would have a material adverse effect on the results of our operations and on our cash flow from operations.

We have invested a substantial portion of our cash in auction-rate securities, which subjects us to liquidity and investment risk. Due to recent uncertainties in the capital markets regarding auction-rate securities, we recorded impairment charges in the fourth quarter of 2007 and the first quarter of 2008, and, if the fair value of these investments were to decline further, we could be required to record further impairment charges related to these investments.

As of December 31, 2007, we held $40.3 million of principal invested in auction-rate securities, which consist of interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Auction-rate securities are floating rate debt securities with long-term nominal maturities for which the interest rates are reset from time to time through a competitive bidding process often referred to as a "Dutch auction." These periodic auctions have historically provided a liquid market for auction-rate securities, as this mechanism generally allows existing investors to rollover their holdings and continue to own their respective securities at then-existing market rates or to liquidate their holdings by selling their securities at par value. Recently, as part of the ongoing credit and financial market crisis, a number of auction-rate securities from various issuers have failed to receive sufficient order interest from potential investors to clear successfully, resulting in auction failures. The result of a failed auction is that the auction-rate security continues to pay interest according to its terms; however, liquidity for holders is limited until there is a successful auction or until such time as another market for the auction-rate securities develops.

While the auction-rate securities held by us had AAA and AA credit ratings at the time of our purchase of these securities, the auction-rate securities held by us have experienced multiple failed auctions. A few of our auction-rate securities have had their credit rating downgraded. As a result, we will not be able to liquidate these securities until a future auction is successful, the issuer redeems the securities, a buyer is found outside the auction process or the securities mature. The securities have maturities ranging from 9 to 45 years following the date of this annual report. We recorded a pre-tax impairment charge of $4.9 million in the fourth quarter of 2007 and an additional pre-tax impairment charge of $2.2 million in the first quarter of 2008. We cannot predict when the liquidity of these auction-rate securities will improve. We continue to monitor the market for auction-rate securities although there is currently a very limited secondary market for such securities. If these investments continue to experience further devaluation, we will record further impairment charges that could adversely affect our consolidated financial condition and results of operations. In addition, if the fair value of certain investments that have not experienced any devaluation were to decline, management would be required to evaluate whether such decline is "other than temporary." The amount of any impairment loss which is determined to be other than temporary would be immediately recorded in the consolidated statement of operations. Such an impairment charge could materially and adversely affect our consolidated financial condition and results of operations. See Note 3 of the notes to our consolidated financial statements for further information.

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 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.

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, 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 Israel and certain other jurisdictions in which we operate is limited. 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 wrongful access to 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 law 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, 2007, we had a limited patent portfolio. We had two issued U.S. patents and two pending U.S. patent applications. We also have one pending counterpart application outside of the United States, filed pursuant to the Patent Cooperation Treaty. 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.

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 claims, 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 a substantial damage award, 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.

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 which support critical applications for subscribers and enterprises. Due to the complexity of our products and variations among customers' network environments, we may not detect product defects until full deployment in our customers' networks. Regardless of whether warranty coverage exists for a product, we may be required to dedicate significant technical resources to resolve 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 revenue, and damage to our reputation. In addition, we could 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.

We need to increase the functionality of our products and offer additional features 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 selling prices for our products may decrease over time. Such a decrease would generally result from the introduction by competitors of competing products and from the standardization of DPI technology. To counter this trend, we endeavor to enhance our products by offering higher system speeds, and additional features, such as additional security functions, supporting additional applications and enhanced reporting tools. We may also need to reduce our per unit manufacturing costs at a rate equal to or faster than the rate at which selling prices decline. If we are unable to reduce these costs or to offer increased functionally and features, our profitability may be adversely affected.

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.

The European Union and China have issued statutes relating to the sale of electrical and electronic equipment, including products sold by us. If our products fail to comply with these statues, we could be subject to penalties and sanctions that could materially adversely affect our business.

A directive issued by the European Union, or EU, on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment, referred to as the EU RoHS directive, came into effect on July 1, 2006. The EU RoHS directive, lists a number of substances, including lead, mercury, cadmium and hexavalent chromium, which must either be removed, or reduced to maximum permitted concentrations, in any products containing electrical or electronic components that are sold within the EU. Our products fall within the scope of the EU RoHS directive. In addition, the Peoples' Republic of China has enacted a law on Management Methods for Controlling Pollution by Electronic Information Products, referred to as the China RoHS directive, that is equivalent of the bans implemented in the EU, but the marking and product certification requirements exceed the requirement of the EU RoHS directive. Furthermore, the scope of this legislation is broader than the EU RoHS directive, covering even medical devices and measurement instruments. We believe that our products are currently compliant with the EU RoHS directive and the China RoHS directive requirements. There can, however, be no assurance that we will continue to comply with the EU RoHS directive, the China RoHS directive or any similar directives in other jurisdictions in the future.

In 2003, the EU approved a directive on Waste Electrical and Electronic Equipment, or WEEE directive, which promotes waste recovery with a view to reducing the quantity of waste for disposal and saving natural resources, in particular by reuse, recycling, composting and recovering energy from waste. The WEEE directive covers all electrical and electronic equipment used by consumers and electronic equipment intended for professional use. The WEEE directive, which went into effect in August 2005, requires that all new electrical and electronic equipment placed for sale in the EU be appropriately labeled regarding waste disposal and contains other obligations regarding the collection and recycling of waste electrical and electronic equipment. Our products fall within the scope of the WEEE directive, with which we believe we are compliant and are taking all requisite steps to ensure continued compliance.

The countries of the EU and the Peoples' Republic of China form the large markets for our products. If our products fail to comply with the WEEE directive, the EU RoHS directive or the China RoHS directive, we could be subject to heavy penalties and other sanctions that could have a material adverse affect on our results of operations and financial condition.

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

In 2007, we derived our revenues principally in U.S. dollars. Although a substantial part of our expenses were denominated in U.S. dollars, a significant portion of our expenses were denominated in shekels and to a lesser extent in euros and other Asian 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 2007, the NIS appreciated 9.0% in comparison to the U.S. dollar. Through June 15, 2008, the NIS appreciated an additional 11% against the U.S. dollar. If the U.S. dollar continues to weaken against the shekel or other currencies we are exposed to, there will be a negative impact on our profit margins. In addition, if we wish to maintain the 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. See "ITEM 11: Quantitative and Qualitative Disclosures about Market Risk."

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 that provide us access to complementary technologies and accelerate our penetration into new markets. In 2008, we acquired the business of Esphion, a developer of network protection solutions for carriers and internet service providers, which increased the scope of our product offering. 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:

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

If acquisitions disrupt our operations, our business may suffer.

Under current U.S. and Israeli law, we may not be able to enforce employees' covenants not to compete 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. These agreements prohibit our employees, if they cease working for us, from competing directly with us or working for our competitors for a limited period. Under current U.S. and Israeli law, we may be unable to enforce these agreements and it may be difficult for us to restrict our competitors from gaining the expertise our former employees gained while working for us.

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:

- announcements or introductions of technological innovations or new products, or product enhancements or pricing policies by us or our competitors;
- 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 product;
- our sale of ordinary shares or other securities in the future;
- changes in the estimation of the future size and growth of our markets; and
- 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. Two securities analysts who covered our company following our initial public offering ceased their coverage in 2007. 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. In April 2007, we announced that our revenue and earnings estimates for the first quarter of 2007 and that the 2007 fiscal year would be lower than previously projected. The closing price of our ordinary shares on the date following the announcement was $2.04, or 22%, lower than the closing price on the previous day. Subsequently, in May and June 2007, we and certain of our officers and directors were named as defendants in a number of purported securities class action lawsuits filed in the United States District Court for the Southern District of New York. See "ITEM 8: Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

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

As a foreign private issuer, we are permitted under Nasdaq Marketplace Rule 4350 to follow Israeli corporate governance practices instead of the Nasdaq Global Market requirements that apply to U.S. listed companies. As a condition to following Israeli corporate governance practices, we must disclose which requirements we are not following and the equivalent Israeli requirement. We must also provide Nasdaq with a letter from our outside counsel in our home country, Israel, certifying that our corporate governance practices are not prohibited by Israeli law. We rely on this "foreign private issuer exemption" with respect to the following two items: First, we follow the requirements of Israeli law with respect to the quorum requirement for meetings of our shareholders, which are different from the requirements of Rule 4350(f). As a result, the quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person, by proxy or by written ballot, who hold or represent between them at least 25% of the voting power of our shares. Second, we follow Israeli law requirements with respect to the requirement to seek shareholder approval for equity compensation plans, which are significantly different the requirements of Rule 4350(i)(1)(A). Under Israeli law, we may amend our 2006 Incentive Compensation Plan by approval of our board of directors and without shareholder approval as is generally required under Rule 4350(i)(1)(A). As a result of these exemptions, our shareholders do not have the same protections as are afforded to shareholders of a U.S. listed company. We may in the future provide Nasdaq with an additional letter or letters notifying Nasdaq that we are following our home country practices, consistent with Israeli law and practices, in lieu of other requirements of Marketplace Rule 4350.

Defending securities class action litigation requires extensive management attention and resources, and an unfavorable outcome could materially adversely affect our business, results of operations and financial condition.

Defending the purported securities class action lawsuits to which we are subject could be expensive, lengthy and disruptive to normal business operations, and could require extensive management attention and resources, regardless of the merit of these lawsuits. Moreover, we cannot predict the results of legal proceedings, and an unfavorable resolution of these lawsuits as a result of a settlement, or a court decision, could materially adversely affect our business, results of operations and financial condition.

A small number of significant beneficial owners of our shares acting together will have a controlling influence over matters requiring shareholder approval, which could delay or prevent a change of control.

The largest beneficial owners of our shares, entities and individuals affiliated with Tamir Fishman Ventures, the Gemini Group, Genesis Partners, the Brookside Capital Fund, the Partech International Group and Odem Rotem Holdings Ltd., a company owned and controlled by our Chairman, Yigal Jacoby, each of which beneficially owns as of June 15, 2008 more than 5.0% of our outstanding shares, beneficially own in the aggregate 56.8% of our ordinary shares. As a result, these shareholders, acting together, could exercise a controlling influence over our operations and business strategy and will have sufficient voting power to control the outcome of matters requiring shareholder approval.

These matters may include:

- the composition of our board of directors which has the authority to direct our business and to appoint and remove our officers;
- approving or rejecting a merger, consolidation or other business combination;
- raising future capital; and
- amending our articles of association which govern the rights attached to our ordinary shares.

This concentration of ownership of our ordinary shares could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our ordinary shares that might otherwise give you the opportunity to realize a premium over the then-prevailing market price of our ordinary shares. This concentration of ownership may also adversely affect our share price.

Future sales of our ordinary shares in the public market and low trading volume could adversely affect our share price.

As of December 31, 2007, we had 22,008,249 ordinary shares outstanding. Approximately 42.3% of these shares are “restricted securities” available for resale on the Nasdaq Global Market subject, however, to volume limitations under Rule 144. Most of these restricted securities are held by the largest beneficial owners of our shares. Future sales of these restricted shares, or the perception that these sales could occur, could adversely affect the market price of our ordinary shares. We have experienced a low trading volume of our ordinary shares since our initial public offering and if one or a small number of parties buys or sells a large number of our ordinary shares, we may experience volatility in our share price and the price and liquidity of our shares may be adversely affected.

Our U.S. shareholders may suffer adverse tax consequences if we are characterized as a Passive Foreign Investment Company.

Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we would be characterized as a passive foreign investment company for U.S. federal income tax purposes. If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our shares treated as ordinary income, rather than capital gain, having imputed interest charges apply to the proceeds of share sales, and the denial of the taxation of dividends received on our shares at the lower rates otherwise applicable to long-term capital gains and imputed interest charges on the proceeds of the sale of our shares. To determine if at least 50% of our assets are held for the production of, or produce, passive income we may use the market capitalization method for certain periods. Under the market capitalization method, our total asset value would be considered to equal the fair market value of our outstanding shares plus outstanding indebtedness on a relevant testing date. Because the market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has historically been especially volatile, and because the market price may affect the determination of whether we will be considered a passive foreign investment company, there can be no assurance that we will not be considered a passive foreign investment company for any taxable year. See “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations.”

If we were characterized as a passive foreign investment company, a U.S. Holder (as defined under ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations) could avoid certain adverse passive foreign investment company consequences described above by making a qualified electing fund election to be taxed currently on its proportionate share of the passive foreign investment company’s ordinary income and net capital gains. However, we do not intend to comply with the necessary accounting and record keeping requirements that would allow a U.S. Holder to make a qualified electing fund election with respect to the Company. See “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations.”

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, and research and development 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. Since October 2000, there has been an increase in hostilities between Israel and the Palestinians. Hamas, an Islamist movement responsible for many attacks, including missile strikes, against Israelis, won the majority of the seats in the Parliament of the Palestinian Authority in January 2006 and took control of the entire Gaza Strip, by force, in June 2007. These developments have further strained relations between Israel and the Palestinian Authority. In July and August 2006, a war was fought between Israel and Hezbollah in Lebanon, including rockets being fired from Lebanon up to 50 miles into Israel. Furthermore, several countries, principally in the Middle East, still restrict doing business with Israel and Israeli companies, and additional countries may impose restrictions on doing business with Israel and Israeli companies if hostilities in Israel continue or increase. These restrictions may limit materially our ability to sell our solutions to companies in these countries. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel, could adversely affect our operations and product development, cause our revenues to decrease and adversely affect the share price of publicly traded companies having operations in Israel, such as us. Additionally, any hostilities involving Israel may have a material adverse effect on either of our principal subcontractors and their facilities in which event, all or a portion of our inventory may be damaged, and our ability to deliver products to customers may be materially adversely affected.

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

As of December 31, 2007, we employed 242 people, of whom 174 were based in Israel. Some of our executive officers and 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 for a significant period of one or more of our executive officers or key employees 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 will be called upon to perform military service, especially in times of national emergency, is difficult to predict. Additionally, the absence of a significant number of the employees at either of our principal subcontractors related to military service may disrupt their operations in which event our ability to 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 Investment Law. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2007, our net operating loss carry forwards for Israeli tax purposes amounted to approximately $38 million. To remain eligible for these tax benefits, we must continue to meet certain conditions stipulated in the Investment 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 the conditions stipulated in the Investment Law and its regulations and the criteria set forth in the specific certificate of approval in the future, the tax benefits would be canceled and we could be required to refund any tax benefits that we have received. These tax benefits may not be continued in the future at their current levels or at any level.

Effective April 1, 2005, the Investment Law was amended. As a result, the criteria for new investments qualified to receive tax benefits were revised. No assurance can be given that we will, in the future, be eligible to receive additional tax benefits under this law. 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 might not be eligible for inclusion in Israeli tax benefit programs. See “ITEM 10: Additional Information—Taxation—Israeli Tax Considerations and Government Programs—Law for the Encouragement of Capital Investments, 1959.”

The government grants we have received for research and development expenditures restrict our ability to manufacture products and transfer technologies outside of Israel and require us to satisfy specified conditions. If we fail to comply with such restrictions or these conditions, 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 of the Ministry of Industry, Trade and Labor, 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 2005, 2006 and 2007, we received and accrued grants totaling $727, $1,811 and $2,371 million from the Office of the Chief Scientist, representing 10.9%, 19.4% and 21.1%, respectively, of our gross research and development expenditures in these periods. We may not receive future grants from the Office of the Chief Scientist and our failure to receive additional grants in the future could adversely affect our profitability.

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 of 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 have the effect of delaying or preventing a change in control and may make it more difficult for a third party 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 in the future for our ordinary shares. Furthermore, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders. See “ITEM 10: Additional Information—Memorandum of Association and Articles of Association—Anti-Takeover Measures” and “—Acquisitions under Israeli Law.”

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 45240, 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 7664 Golden Triangle Drive, Eden Prairie, MN 55344.

We were incorporated in late 1996 as "Ariadne Ltd." and commenced operations in 1997. In September 1997, we changed our name to "Allot Communications Ltd." We recently 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.

We had capital expenditures of $3.0 million in 2007, $2.1 million in 2006 and $0.7 million in 2005. We have financed our capital expenditures with cash generated through net proceeds from our initial public offering, private placements of our equity securities and from operations.

Our capital expenditures during 2005 consisted primarily of investments in research and development equipment. In 2006 and 2007, our capital expenditures consisted primarily of investments in research and development equipment and in leasehold improvements.

B. Business Overview

Overview

We are a leading provider of intelligent IP service optimization solutions for DSL, wireless and mobile broadband carriers, cable operator service providers, and enterprises. Our portfolio of hardware platforms and software applications utilizes advanced deep packet inspection, or DPI, technology to transform broadband pipes into smart networks that can rapidly and efficiently deploy value added Internet services. Our scalable, carrier-grade solutions provide the visibility, security, application control and subscriber management that are vital to managing Internet service delivery, guaranteeing quality of experience, or QoE, containing operating costs, and maximizing revenue in broadband networks.

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.

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

The increasing adoption of broadband access has enabled significant advances in the sophistication of applications delivered over broadband networks. In contrast to traditional applications, such as e-mail and web-browsing, many newer applications, such as P2P, VoIP, internet video, online video gaming and online content sites, require large amounts of bandwidth and are highly sensitive to network delays. 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.

Service Providers Demand for the Ability to Offer Premium and Differentiated Services

Most service providers offer flat-fee 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. In addition, competition among service providers has increased because of multiple broadband delivery options, such as cable, DSL, wireless and satellite. As a result of these factors, broadband access has become a commodity, contributing to downward price pressure and high churn rates.

To address these issues and increase the average revenue per user, or ARPU, service providers have begun to offer premium, differentiated applications, such as VoIP, video and new online content services. However, these service providers have as yet been unable to offer guaranteed service levels for these applications on an individual subscriber basis. By offering such tiered services and charging subscribers according to the value of these services, service providers can capitalize on the revenue enhancement opportunities enabled by broadband applications. To offer premium services and to guarantee service levels for those services, service providers need enhanced visibility into network traffic, including visibility into the type of applications used on the network and levels of traffic generated by different subscribers.

Increasing Enterprise Demand for Visibility and Delivery of Mission-Critical Applications

The proliferation of network applications also presents significant challenges for enterprises operating wide-area networks. Applications such as e-mail, customer relationship management, or CRM, enterprise resource planning and other online transactional and business applications are critical to enterprises' ability to operate efficiently. Enterprises have also become increasingly dependent on broadband Internet and Intranet access, as content distribution between partners and customers, employee remote access, and even VoIP, have become more common. At the same time, the openness of the Internet allows employees to use a wide variety of recreational and non-business applications on enterprise networks, resulting in network congestion and negatively impacting employee productivity. As a result, enterprises have experienced diminished performance of their mission-critical applications.

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 attacks such as worms, viruses and spam. The attacks hinder the ability of service providers to provide high quality broadband access to subscribers, prevent enterprises from using mission-critical applications and compromise network and data integrity. We believe that users increasingly expect service providers to protect them from these threats. Therefore, it has become imperative for service providers and enterprises to identify and block malicious traffic at very early stages.

The Challenge of Implementing Intelligent Networks

Service providers are seeking to transform generic access broadband networks into intelligent broadband networks. The ability to identify, distinguish and prioritize different network applications plays a major role in intelligent network management, allowing service providers to optimize bandwidth usage and reduce operational costs, while maintaining high quality of service. 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. The dilemma of implementing intelligent networks is further complicated by today's higher speed broadband networks which carry tremendous amounts of data and serve millions of customers. Unlike traditional network infrastructure devices, such as switches and routers, which can perform only a very limited examination of packets, DPI solutions offer active management of each application and subscriber in the network requiring significant processing power and speed, greater memory and special algorithms.

The Allot Solution

Our solutions employ advanced DPI, which identifies applications by examining the content encapsulated in packets, including header and application information. By correlating data from multiple packets and flows, searching for application signatures and recognizing application behavior, our solutions identify each subscriber and application in the network and provide in-depth, real time information about their behavior. Once an application has been identified, it can be managed using predetermined policies that determine the level of network resources allocated for that application based on the business strategy of the service provider or enterprise. We have developed market-leading DPI technology that accurately identifies hundreds of application protocols at higher speeds and creates customized detailed usage analyses and reports. Our vision is that DPI technology will become a platform for a range of value-added services, rather than an added feature on a router. Once our DPI engine is able to provide information regarding applications running over the network, we believe our platform will enable service providers to use this information to drive additional revenues by enabling additional functionalities on our DPI platform. We have recently acquired the business of Esphion, a developer of network protection solutions for carriers and internet service providers, which increased the scope of our product offering.

Our Products

Traffic Management Systems

Our traffic management systems consist of the Service Gateway platform and the NetEnforcer product line.

The Service Gateway platform is an open standards-based platform for broadband service control and optimization based on DPI. It is based on an AdvancedTCA®-compliant chassis with modular, hot-swappable DPI blades. A single platform provides four 10 Gigabit Ethernet ports, that manage two 10 Gigabit Ethernet lines, supporting more than 20 Gigabits per second (Gbps) of traffic. Within the Service Gateway, the application and subscriber information for each traffic flow is identified by a single DPI process that can then dispatch the flow to an array of additional services and actions. These actions may, through additional blades on the platform, include traffic prioritization and Quality of Service, or QoS, optimization, filtering (including parental control), blocking security threats (Clean Line and denial-of-service-prevention) or collecting records for real-time charging or offline usage-based charging.

The Service Gateway is designed to reduce the cost and complexity of developing new services. It increases operation efficiency by enabling service providers to deploy multiple services through a single multi-purpose platform rather than by using multiple single purpose appliances. Using the Service Gateway, service providers are able to manage all services using the same policy control rules and management application. The Service Gateway enables providers to minimize the number of packets handled by each application for all services by leveraging a single DPI process.

The Service Gateway – Omega Series also leverages our powerful NetXplorer centralized management software and is fully integrated with our Subscriber Management Platform, described below.

Our NetEnforcer traffic management system inspects, monitors and controls network traffic by application and by user. NetEnforcer devices are positioned at multiple strategic network locations where the most traffic traverses and can be monitored and managed. These locations include network access points, or “peering points,” where the network connects to other networks and data centers. NetEnforcer includes its own management software and can also be managed by other vendor management applications through an interface that integrates with the end-customer’s operating environment. These applications include policy servers, provisioning systems, customer care and billing applications.

Our traffic management devices are available in several different models to address the needs of a wide range of service providers and enterprises:

Series	Target Market	Operation Speeds	Subscribers(1)
NetEnforcer AC-400	Small to medium enterprise networks and service provider networks	Up to 100 Mbps	Up to 4,000
NetEnforcer AC-800	Medium and large enterprise networks and medium service provider networks	Up to 310 Mbps	Up to 28,000
NetEnforcer AC-1000/ AC-2500	Carrier-class solutions used by medium and large service provider networks	Up to 1 Gbps and 5 Gbps, respectively	Up to 80,000
Service Gateway – Omega Series	Carrier-class solutions used by medium and large service provider networks	Up to 25 Gbps	Up to 800,000

(1) Represents the maximum number of subscribers that a system can handle simultaneously. Typically, due to network topology, redundancy requirements and other constraints, such as total bandwidth available per subscriber, the actual number per product unit is lower.

Our Service Gateway platform, NetEnforcer AC-1000 and AC-2500 are designed to meet NEBS Level 3 certification requirements to ensure operation in extreme environmental conditions.

Network Management Application Suites

Our network management application suites consist of the NetXplorer management application and the Subscriber Management Platform.

The NetXplorer management application suite provides service providers and enterprise customers a highly granular, real time view of all traffic on the network. This centralized management suite, which replaces our previous management applications, works in conjunction with our Service Gateway and NetEnforcer products to provide network traffic intelligence and enable enterprises and service providers to effectively manage broadband services and set policies for the use of their networks. The data provided from multiple systems are aggregated, analyzed and conveyed using our NetXplorer management application suite.

NetXplorer architecture consists of four elements: first, the client element is the NetXplorer graphical user interface application; second, the server element consisting of the actual NetXplorer application, including the database; third, the optional collector element, which assists in collecting large amounts of data from multiple Service Gateways or NetEnforcers; and fourth, an agent element that is an add-on to the Service Gateway or the NetEnforcer that enables them to be managed by the NetXplorer and support all network management functions.

Our Subscriber Management Platform, or SMP, is a scalable system that helps service providers build an intelligent service network designed to deliver the QoE that each subscriber expects, while allowing providers to manage network usage. The SMP monitors subscriber behavior to identify, track and report short- or long-term usage trends. Behavior can be tracked on an individual basis or for groups of subscribers. By analyzing these trends, providers can know which services are the most popular and with whom. This allows the provider to quickly roll out new or packaged services based on individual subscriber demand and preferred delivery. The SMP supports per-subscriber QoS policy definition, enabling providers to rapidly create and deploy tiered service plans that allow different subscribers to have different quality parameters on a per-service basis. This capability, together with the SMP's tiered services control and quota management features, create unlimited opportunity for innovative service packaging and pricing based on individual subscriber demand and preferred delivery. This flexible and customized delivery helps service providers increase ARPU, reduce churn and facilitate the introduction of new revenue-generating services without service interruption.

ServiceProtector

Our ServiceProtector ensures service continuity and guards network integrity against known and unknown threats. Through immediate identification of Denial of Service (DoS/DDoS) attacks, Zero Day attacks, worms, zombie and spambot behavior, the ServiceProtector enables fast, surgical mitigation by automatically blocking, limiting or isolating only the offending traffic while allowing legitimate traffic to flow. The ServiceProtector's scalable, carrier-grade performance is compatible with 1 Gbps and 10 Gbps networks.

Customers

We have a global, diversified end-customer base consisting primarily of service providers and enterprises. Our direct customers are generally distributors, resellers, OEMs and system integrators, who we refer to as our channel partners. In 2007, we derived 39% of our revenues from Europe, the Middle East and Africa, 31% from the Americas and 30% from Asia and Oceania. We generally only have direct contact with end-customers in the case of larger projects, as smaller projects are driven by our channel partners.

Channel Partners

We market and sell our products to end-customers through variety of channels, including direct sales and through our channel partners, which include distributors, resellers, OEMs and system integrators. 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 for an initial term of one year and automatically renew for successive one-year terms unless terminated. After the first year, such agreements may be terminated by either party upon ninety days prior notice. These agreements are generally non-exclusive and generally contain minimum purchase requirements and we are permitted to terminate the agreement in the event of a failure to meet such targets.

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.

Our sales staff's direct contact with end-customers consists mainly of developing leads for our channel partners. A vast majority of our sales occur through our channel partners.

Sales and Marketing

The sales and deployment cycle for our products varies based upon the intended use by the end-customer. The sales cycle for initial network deployment may last between one and three years 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 DPI 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 U.S., Israel, France, Spain, United Kingdom, Singapore, Japan and China, and a dedicated regional presence in Germany, Italy, the Czech Republic and Australia. We also maintain a regional presence in Mexico and Brazil.

As of December 31, 2007, our sales and marketing staff consisted of 50 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-user networks. Our basic warranty extended to end-customers through our channel partners is three months for software and twelve months for hardware. Generally, end-customers are also offered, through our channel partners, a choice of one year or three-year customer support programs when they purchase our products. These warranties can be renewed at the end of their terms. Our end-customer support plans offer the following features:

- expedited replacement units in the event of a warranty claim; and
- software updates and upgrades offering new features and addressing new network applications.

Our channel partner support plans are designed to maximize network up-time and minimize operating costs. Our 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, located in France, Israel, Singapore and the United States. We also offer our channel partners 24-hour access to an external web-based technical knowledge base, which provides technical support information and enables them to support their customers independently and obtain follow up and support from us. We manage our channel partner and customer support efforts through a single database which enables us to track seamlessly any response provided to a channel partner or end-customer from a different office and to escalate automatically any customer inquiry after a predetermined period of time.

As of December 31, 2007, our technical staff consisted of 43 employees.

Research and Development

Our research and development activities take place in Israel and New Zealand. As of December 31, 2007, 89 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. 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 restrict our ability to manufacture products and transfer technologies outside of Israel and require us to satisfy specified conditions. If we fail to comply with such restrictions or these conditions, 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 NetEnforcer products to R.H. Electronics, an Israeli manufacturer and manufacture and repair of our Service Gateway platform 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. R.H. Electronics and Flextronics (Israel) are 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 submit advance forecasts of our projected requirements and our contractors are required to maintain an inventory of components sufficient to support the manufacture of an agreed number of our units beyond these projections. We are not required to provide any minimum orders. Our agreement with each contractor is automatically renewed annually for additional one-year terms. R.H. Electronics may elect not to renew our agreement with them by giving us at least 90 days prior notice to the expiration of any such term. Furthermore, R.H. Electronics may terminate our agreement at any time during the term upon 120 days prior notice. 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. Both contractors have U.S. affiliates to which they 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 our product's hardware components 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 platform from Raza Microelectronics, Inc. and for our NetEnforcer AC-400 and our NetEnforcer AC-800 from Intel Corporation and we have agreed to purchase the network processor for our NetEnforcer AC-1000 and our NetEnforcer AC-2500 from Hifn Inc. 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 the products. We have been informed by Hifn that it is their general policy to provide their customers with a six-month last-time-buy option and twelve months to take delivery of the product in the event that Hifn decides to discontinue production of the network processor. 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

Our principal competitors are Cisco Systems, Sandvine and Arbor Networks, Inc. (through its acquisition of Ellacoya Networks) in the service provider market, and Blue Coat Systems, Inc. (through its acquisition of Packeteer) in the enterprise market. We also compete with a number of smaller competitors such as CloudShield Technologies, Inc. and Procera Networks, Inc. and we compete indirectly with router and switch infrastructure companies that offer features, which address some of the problems that our products address. We also face competition from companies that offer partial solutions addressing only one aspect 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 trademarks 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, 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, non-disclosure of all confidential information, and non-compete clauses non-compete clauses, which generally restrict the employee for six months following termination of employment. The enforceability of non-compete clauses in Israel and certain other jurisdictions in which we operate is limited. 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, 2007, we had two U.S. patents and two pending patent applications in the United States. We also have one pending counterpart application outside of the United States, filed pursuant to the Patent Cooperation Treaty. 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 U.S. trademark registrations for certain of our key marks that we use to identify our products or services, including "NetEnforcer" and "Allot Communications."

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

We conduct our global operations through six wholly-owned subsidiaries: (1) Allot Communications, Inc., headquartered in Eden Prairie, Minnesota; (2) Allot Communication Europe SARL, headquartered in Sophia, France; (3) Allot Communications Japan K.K., headquartered in Tokyo, Japan; (4) Allot Communication (UK) Limited, headquartered in Bedford, England; (5) Allot Communications (Asia Pacific) Pte. Ltd., headquartered in Singapore; and (6) Allot Communications (New Zealand) Limited, headquartered in Auckland, New Zealand. Our U.S. subsidiary commenced operations in 1997 and engages in the sale, marketing and technical support services in the United States of products manufactured by and imported from our company. Our French, U.K., Japanese and Singapore subsidiaries engage in marketing and technical support services of our products in Europe, Japan and Asia Pacific, respectively. Our New Zealand subsidiary engages in development and technical support services.

D. Property, Plants and Equipment

Our principal administrative and research and development activities are located in a 39,245 square foot (3,646 square meter) facility in Hod-Hasharon, Israel. The lease for this facility commenced in August 2006 and will expire in August 2013. We believe that this facility will be adequate to meet our needs in Israel for at least the next twelve months.

We also lease a 5,812 square foot (539 square meter) facility in Eden Prairie, MN, for the purposes of our U.S. sales and marketing operations pursuant to a lease that expires in August 2008. We lease other smaller facilities for the purpose of our development, sales and marketing and support activities in the U.S., France, the United Kingdom, Germany, the Czech Republic, 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 designer and developer of broadband service optimization solutions using advanced DPI technology. Our solutions provide broadband service providers and enterprises with real-time, highly granular visibility into, and control of, network traffic, and enable them to efficiently and effectively manage and optimize their networks. 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. 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. 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 and wireline Internet service providers, educational institutions, governments and enterprises.

There has been a rapid proliferation of broadband networks in recent years which 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. The Internet, which was designed originally to support web surfing and e-mail applications, now supports numerous advanced services, such as interactive gaming, video conferencing and IPTV. In addition, there has been an exponential increase in over-the-top Internet services, such VoIP and video streaming. These new applications are driving large service providers to explore ways to efficiently manage bandwidth resources in view of these and other bandwidth-heavy applications. As a result, a number of these service providers are considering deploying DPI technology in their networks. We believe that large service providers, as well as cable operators and mobile operators, present a significant market opportunity and are an important element of our long term strategy.

Acquisition of Esphion

On January 8, 2008, we acquired the business of Esphion Limited, a New Zealand-based a developer of network protection solutions for carriers and internet service providers, for $3.5 million in cash plus up to additional $2 million of performance-based consideration if certain performance targets are met during 2008. We believe that this acquisition furthers our vision of offering value-added services for our Service Gateway platform to help broadband providers build secure, intelligent networks.

Revenues

We generate revenues from two sources: (1) sales of our network traffic management systems and our 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 grant a one-year hardware warranty and a three-month software warranty on all of our products and record a liability 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. We recognize revenues associated with our maintenance and support programs on a straight-line basis over the term of the maintenance and support agreement. See "—Critical Accounting Policies and Estimates—Revenue Recognition" below.

Customer concentration. We derived approximately 9% of our revenues in 2005, 5% of our revenues in 2006 and 6% of our revenues in 2007 from a single U.S. distributor of our products to other resellers and system integrators in the United States. We derived 16% of our revenues in 2005, 20% of our revenues in 2006 and 0% of our revenues in 2007 from a single system integrator for our products in the United Kingdom, primarily in connection with the deployment of our products by NTL Group Limited, a leading United Kingdom cable operator.

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

	Year Ended December 31,		
	2005	**2006**	**2007**
United Kingdom	25%	25%	6%
United States	29	22	20
Europe (excluding United Kingdom)	21	24	27
Asia and Oceania	18	20	30
Middle East and Africa	4	5	6
Americas (excluding United States)	3	4	11
Total	100%	100%	100%

The decrease in our revenues in the United Kingdom in 2007 compared to 2005 and 2006 is principally attributable to NTL Group Limited, a large United Kingdom service provider, having completed its deployment of our products throughout its network in 2006.

Cost of revenues and gross margins

Our product cost of revenues consists primarily of costs of materials, manufacturing services and overhead, warehousing, testing and royalties paid primarily to the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor. Our services cost of revenues consist 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 the increase in our product and service revenues, the increased sales of our higher end products, primarily consisting of our Service Gateway – Omega Series and sale of extended service suites to large scale customers that will require additional personnel hiring and other expenditures. As a result, our gross margins as a percentage of revenues may decrease.

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 our 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 is essential to our future success and expect that in future periods our research and development expenses will increase on an absolute basis. The acquisition of Esphion's business will cause a significant increase in our research and development expenses in fiscal year 2008.

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 our activities to target 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, continue to promote our brand, establish marketing channels and expand our presence worldwide.

General and administrative. Our general and administrative expenses consist primarily 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. These expenses include additional costs associated with corporate governance, tax compliance, compliance with the rules implemented by the U.S. Securities and Exchange Commission and Nasdaq, premiums for our director and officer liability insurance and for defending the class action lawsuit filed in the United States District Court for the Southern District of New York against us and certain of our directors and officers. See "ITEM 8: Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

Stock-based compensation. We have granted options to purchase our ordinary shares to our employees and consultants at prices below the fair market value of the underlying ordinary shares on the grant date. These options were considered compensatory because the deemed fair market value of the underlying ordinary shares was greater than the exercise prices determined by our board of directors on the option grant date. The determination of the fair market value of the underlying ordinary shares prior to our initial public offering involved subjective judgment, third party valuations and the consideration by our board of directors of a variety of factors. Because there was no public market for our ordinary shares prior to our initial public offering, the amount of the compensatory charge was not based on an objective measure, such as the trading price of our ordinary shares. As of January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R) “Share Based Payment,” or SFAS No. 123(R), which requires us to expense the fair value of employee stock options. We adopted the fair value recognition provisions of SFAS No. 123(R), using the modified prospective method for grants that were measured using the fair value method and adopted SFAS No. 123(R) using the prospective-transition method for grants that were measured using the Minimum Value method in Statement of Financial Accounting Standards No. 123 “Accounting for Stock-Based Compensation,” or SFAS No. 123, for either recognition or pro forma disclosures. The fair value of stock-based awards granted after January 1, 2006, was estimated using the binominal model.

In connection with the grant of options, we recorded total stock-based compensation expense of $305,000 in 2005, $1.4 million in 2006 and $1.4 million in 2007. In 2007, $48,000, $230,000, $340,000 and $743,000 of our stock-based compensation expense resulted from cost of revenue, research and development expenses, sales and marketing expenses and general and administrative expenses, respectively, based on the division in which the recipient of the option grant was employed. As of December 31, 2007, we had an aggregate of $4.9 million of deferred unrecognized stock-based compensation remaining to be recognized. We estimate that this deferred unrecognized stock-based compensation balance will be amortized as follows: $1.9 million in 2008, $1.8 million in 2009 and $1.2 million in 2010 and thereafter.

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, devaluation of marketable securities and bank fees.

As of December 31, 2007, we had $40.3 million of principal invested in Auction-Rate Securities, or ARS, which were rated AAA and AA at the time of purchase. Due to the continued deterioration of, and uncertainties in, the credit and capital markets that began in the second half of 2007, our ARS have experienced multiple failed auctions due to a lack of liquidity in the market. A few of our ARS have had their credit rating downgraded. To date, our ARS have paid interest in accordance with their stated terms. Based on valuation reports received from investment banks, we have recorded an impairment charge of $4.9 million to financial and other expenses, net, in our statement of operations with respect to devaluation, which is considered “other than temporary.” In addition, all of our ARS have been classified as long term assets. If uncertainties in the credit and capital markets continue, these markets deteriorate further or we experience any ratings downgrades on any ongoing investments in our portfolio, including of ARS, we may incur additional impairments to our investment portfolio and record further impairment charges to our financial and other expenses, net, in our statement of operations.

In addition, the financial and other income (expenses), net, may fluctuate due to foreign currency exchange gains or losses. See also paragraph "ITEM 11: Quantitative and Qualitative Disclosures About Market Risk – Foreign Currency Exchange Risk."

Tax Reform

On January 1, 2003, a comprehensive tax reform took effect in Israel. Pursuant to the reform, resident companies are subject to Israeli tax on income accrued or derived in Israel or abroad. In addition, the concept of controlled foreign corporation, or CFC, was introduced according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if, among other things, the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains).

Our facilities in Hod-Hasharon, Israel have been granted Approved Enterprise status under the Investment Law and enjoy certain tax benefits. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2007, our net operating loss carry forwards for Israeli tax purposes amounted to approximately $38 million. Income derived from other sources, other than the "Approved Enterprise," during the benefit period will be subject to tax at the regular corporate tax rate. For more information about the tax benefits available to us as an Approved Enterprise see "ITEM 10: Additional Information—Taxation and Government Programs—Law for the Encouragement of Capital Investments, 1959."

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 Israeli Law for Encouragement of Research and Development in the Industry, 1984, or the Research and Development Law. Through December 31, 2007, we had applied and received approval for grants totaling $13.6 million from the Office of the Chief Scientist, of which $4.1 million is attributed to NetReality products. 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 with 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 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 consolidated sales of our products and no payment is required if no sales are made. As of December 31, 2007, we had an outstanding contingent obligation to pay royalties in the amount of $5.9 million.

The government of Israel does not own proprietary rights in knowledge developed using its funding and there is no restriction related to such funding on the export of products manufactured using the know-how. The know-how is, however, subject to other legal restrictions, including the obligation to manufacture the product based on the know-how in Israel and to obtain the Office of the Chief Scientist's consent to transfer the know-how to a third party, whether in or outside Israel. These restrictions may impair our ability to outsource manufacturing or enter into similar arrangements for those products or technologies and they continue to apply even after we have paid the full amount of royalties payable for the grants.

If the Office of the Chief Scientist consents to the manufacture of the products outside Israel, the regulations allow the Office of the Chief Scientist to require the payment of increased royalties, ranging from 120% to 300% of the amount of the grant plus interest, depending on the percentage of foreign manufacture. If the manufacturing is performed outside of Israel by us, the rate of royalties payable by us on revenues from the sale of products manufactured outside of Israel will increase by 1% over the regular rates. If the manufacturing, marketing and distribution is carried outside of Israel, the rate of royalties payable by us on those revenues will be calculated in accordance with the proportion between the grant received and the grant plus the amount of our own investments in research and development for such technology. The Research and Development Law further permits the Office of the Chief Scientist, among other things, to approve the transfer of manufacturing or manufacturing rights outside Israel in exchange for an import of certain manufacturing or manufacturing rights into Israel as a substitute, in lieu of the increased royalties.

The Research and Development Law provides that the consent of the Office of the Chief Scientist for the transfer outside of Israel of know-how derived out of an approved plan may only be granted under special circumstances and subject to fulfillment of certain conditions specified in the Research and Development Law as follows: (a) the grant recipient pays to the Office of the Chief Scientist an amount based on the scope of the support received, the royalties that were paid by the company, the amount of time that elapsed since the date on which the grants were received, and the sale price (according to certain formulas), except if the grantee receives from the transferee of the know-how an exclusive, irrevocable, perpetual unlimited license to fully utilize the know-how and all related rights; (b) the grant recipient receives know-how from a third party in exchange for its Office of the Chief Scientist funded know-how; or (c) such transfer of Office of the Chief Scientist funded know-how arises in connection with certain types of cooperation in research and development activities.

In September 2002, we acquired the assets of NetReality, an Israeli manufacturer, from a receiver pursuant to a court ruling. In connection with the NetReality acquisition, we assumed a commitment to pay royalties to the Office of the Chief Scientist up to the amount of the contingent liabilities derived from the grants that had been received by NetReality prior to the acquisition. Following the acquisition of NetReality, the Office of the Chief Scientist merged the NetReality approved plans with our other approved plans under a unified file. In April 2007, the Office of the Chief Scientist notified us of its decision, per our request, to separate the NetReality related approved plans from other approved plans. The Office of the Chief Scientist also approved the discontinuation of the NetReality related approved plans and as a result the balance of our outstanding contingent obligation to pay royalties was reduced by $4.7 million.

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:

Size of end-customers and sales cycles. We have a global, diversified end-customer base consisting primarily of service providers and enterprises. We are making efforts to increase our sales to large service providers. 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 – Omega systems compared to the number required by large service providers. Large service providers take longer to plan the integration of DPI 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 – Omega systems. We are seeking to achieve significant customer wins in the large service provider market that will positively impact future performance. However, our performance is also influenced by sales cycles for our products, which typically fluctuate based upon the size and needs of end-customers that purchase our products. We expect that increased sales to large service providers of Service Gateway systems will result in longer sales cycles that will increase unpredictability regarding 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, until the time that we generate revenue from related product sales.

Average selling prices. Our performance is affected by the selling price 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 price, we expect that we will need to enhance the functionality of our existing products by offering higher system speeds, and additional features, such as additional security functions, supporting additional applications and 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, primarily to higher end models. Such enhanced products typically increase our average selling price. To further offset such declines, we sell maintenance and support programs on our products, and as our customer base and number of field installations grows 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 23.6% for 2005, 22.2% for 2006 and 24.7% for 2007. 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 costs 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. Since our cost of revenues also include royalties paid to the Office of the Chief Scientist, our cost of sales may be impacted positively or negatively by actions of the Israeli government changing the royalty rate. Our products incorporate features that require payment of royalties to third parties. In addition, new products, such as the Service Gateway platform, 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 growth of our customer base is usually coupled with increased service revenues and demand for extended service suites by our large services providers and Tier 1 carriers 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 U.S. dollars. However, a significant portion of the expenses associated with our global operations, including personnel and facilities related expenses, are incurred in currencies other than U.S. dollar. This is the case in primarily in Israel and to a lesser extent in certain 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.

Over the past two years, the U.S. dollar has devaluated relative to the Israeli currency, the New Israeli Shekel, or the NIS. In 2007, the U.S. dollar depreciated against the NIS by 9.0%. During the first half of 2008, this devaluation trend was accelerated. This trend occurred as well in respect to the exchange rate of the U.S. dollar and other currencies. If this trend continues, our U.S. dollar-measured results of operations might be adversely affected.

In addition, since certain assets and liabilities on our balance sheet are denominated in currencies other than U.S. dollar, our financial and other income (expenses), net, may fluctuate due to revaluation and/or realization of these assets and liabilities in exchange rates other than those prevailing at the time in which these assets and/or liabilities were incurred.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 guided by observing the following critical accounting policies:

Revenue recognition. We recognize revenues from sales of our products in accordance with the American Institute of Certified Public Accountants' Statement of Position, or SOP, 97-2, "Software Revenue Recognition," as modified by SOP 98-9, "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions." When an arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collection is probable.

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

Many of our product sales include multiple elements. Such elements typically include several or all of the following: hardware appliance, software licenses, hardware and software maintenance, technical support and training services. For multiple-element arrangements that do not involve significant modification or customization of the software and do not involve services that are considered essential to the functionality of the software, we use the residual method to allocate value to each element when sufficient specific objective evidence exists for all undelivered elements, but does not exist for the delivered element, typically the hardware appliance and software license. Under the residual method, each undelivered element is allocated value based on customer specific objective evidence of fair value for that element, as described above, and the remainder of the total arrangement fee is allocated to the delivered element(s). If sufficient customer specific objective evidence does not exist for all undelivered elements, revenue is deferred for the entire arrangement until all revenue recognition criteria are met for such undelivered elements.

Accounting for Stock-Based Compensation. Effective January 1, 2006, we adopted SFAS No. 123(R), which supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all equity-based payments to employees, including grants of employee stock options, to be recognized in the statement of income based on their fair values. We elected the modified-prospective method and therefore prior periods were not restated. Under the modified-prospective method, compensation costs recognized in 2007 include also compensation costs for all share-based payments granted prior to, but not yet vested, as of December 31, 2007. In 2007, we recognized equity-based compensation expense under SFAS No. 123(R) in the amount of $1.4 million. When calculating this equity-based compensation expense we took into consideration awards that are ultimately expected to vest. Therefore, this expense has been reduced for estimated forfeitures. In our pro forma information required under SFAS No. 123 for the periods prior to fiscal 2006, we accounted for forfeitures as they occurred. We elected to apply the intrinsic value-based method prescribed in APB Opinion No. 25 for our equity-based compensation to employees and directors and provide the pro forma disclosure provisions of SFAS No. 123, as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of SFAS No. 123." As such, we computed and recorded compensation expense for grants whose terms were fixed with respect to the number of shares and option price only if the market price on the date of grant exceeded the exercise price of the stock option. The compensation cost for the fixed plans was recorded over the period the employee performs the service to which the stock compensation relates.

Inventories. We value our inventories at the lower of cost or estimated market value. Cost being determined on the basis of First In, First Out ("FIFO") cost method for raw materials and out-of-pocket manufacturing costs. Indirect costs are allocated on 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. Once inventory is written off, a new cost basis for these assets is established for future periods. Inventory write offs totaled $0.2 million in 2005, $0.3 million in 2006 and $0.2 million in 2007.

Marketable securities. We account for our investments in marketable securities using Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities," or SFAS No. 115. Our management determines the appropriate classification of marketable securities at the time of purchase and evaluates such designation as of each balance sheet date. To date, all debt securities have been classified as available-for-sale and are carried at fair market value. Fair value is determined based on observable market value quotes or, if market values are not available, using valuation models including assessments of counterparty credit worthiness, credit default risk, underlying security type of collaterals risk premium and overall capital market liquidity conditions. Declines in fair value that are considered other-than-temporary are charged to earnings and those that are considered temporary are reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The cost of securities sold is based on the specific identification method. As of December 31, 2007, we held marketable securities in U.S. dollars in the United States, which were classified as available for sale. The balance was composed of ARS and corporate bonds. The ARS and corporate bonds bear interest at rates ranging from 4.59% to 7.55% per annum.

Following SEC Staff Accounting Bulletin No. 59, EITF 03-1 and FAS 115-1, management evaluated in each period whether declines in the market value of its securities are other than temporary. Where such declines are determined to be other than temporary, the related unrealized loss is recorded as a write-down included in financial expenses.

We recorded a pre-tax impairment charge relating to our investments in ARS of $4.9 million in the fourth quarter of 2007 and an additional pre-tax impairment charge of $2.2 million in the first quarter of 2008. See "ITEM 3: Key Information—Risk Factors—We have invested a portion of our cash in auction-rate securities, which subjects us to liquidity and investment risk. Due to recent uncertainties in the capital markets regarding auction-rate securities, we recorded impairment charges in the fourth quarter of 2007 and the first quarter of 2008, and, if the fair value of these investments were to decline further, we could be required to record further impairment charges related to these investments."

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board, or the FASB, issued the Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," or SFAS No. 157. This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. The statements does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007. On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," or FSP No. 157-2. FSP 157-2 amends SFAS No. 157 to delay the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, FSP No. 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact on our consolidated financial statements of adopting SFAS No. 157.

In February 2007, the FASB issued the Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities,” or SFAS No. 159. This statement provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The SFAS No. 159 objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007. The adoption of SFAS No. 159 will not have effect on our consolidated financial statements.

In December 2007, the FASB issued the Statement of Financial Accounting Standards No. 141R, “Business Combinations,” or SFAS No. 141R. SFAS No. 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS No. 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company executes will be recorded and disclosed following existing GAAP until January 1, 2009. We expect that SFAS No. 141R will have an impact on our consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions we consummate after the effective date. We are still assessing the impact of this standard on our future consolidated financial statements.

In December 2007, the SEC staff issued Staff Accounting Bulletin No. 110, or SAB 110, which, effective January 1, 2008, amends and replaces SAB 107, Share-Based Payment. SAB 110 expresses the views of the SEC staff regarding the use of a “simplified” method in developing an estimate of expected term of “plain vanilla” share options in accordance with SFAS No. 123(R). Under the “simplified” method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. The use of the “simplified” method, which was first described in SAB 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the “simplified” method for “plain vanilla” awards in certain situations. The SEC staff does not expect the “simplified” method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. We are currently assessing the potential impact that the adoption of SAB 110 could have on our consolidated financial statements.

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,		
	2005	2006	2007
Revenues:			
Products	80.5%	84.2%	77.1%
Services	19.5	15.8	22.9
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Products	19.5	18.8	20.3
Services	4.1	3.4	4.4
Total cost of revenues	23.6	22.2	24.7
Gross profit	76.4	77.8	75.3
Operating expenses:			
Research and development, net	25.8	22.1	28.9
Sales and marketing	51.7	45.3	55.6
General and administrative	10.4	10.2	17.2
Total operating expenses	87.9	77.5	101.7
Operating income (loss)	(11.5)	0.3	(26.4)
Financing and other income (expenses), net	0.2	1.9	(2.6)
Income (loss) before income tax benefit (expense)	(11.3)	2.2	(29.0)
Income tax benefit (expense)	1.0	0.3	1.6
Net income (loss)	(10.3)	1.8	(30.6)

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues

Products. Product revenues decreased by $3.7 million, or 13%, to $25.1 million in 2007 from $28.8 million in 2006. The majority of our product revenue in 2007 was derived from sales of our NetEnforcer AC-1000 and AC-2500, and to a lesser extent, from the Service Gateway – Omega, which are targeted primarily at large and medium service providers. The decrease is primarily attributable to the completion in 2006 of a project that generated revenues of $6.9 million from a single system integrator.

Services. Service revenues increased by $2.0 million, or 37%, to $7.4 million in 2007 from $5.4 million in 2006. The increase in service revenues resulted primarily from a larger customer base and increased field installations covered by maintenance and support contracts.

Revenues from products, which comprised 77.1% of our total revenues in 2007, decreased by 7.1% compared to 2006, while the service revenues increased by a comparable amount.

Cost of revenues and gross margin

Products. Cost of product revenues increased by $0.2 million, or 3%, to $6.6 million in 2007 from $6.4 million in 2006. This increase resulted primarily from growth in salaries and overhead expenses. Product gross margin was 73.7% in 2007 compared to 77.6% in 2006. This decrease is primarily attributable to increased expenses attributable to salaries, third-party royalties and overhead expenses combined with higher sales volume of our high-end products, which require higher material and labor costs than other products.

Services. Service cost of revenues increased by $0.2 million, or 17%, to $1.4 million in 2007 from $1.2 million in 2006. This increase resulted primarily from an increase in post-sales support expenses caused by employing additional post-sale support engineers and salary increases. Services gross margin was 80.9% in 2007 compared to 78.4% in 2006.

Total gross margin was 75.3% in 2007 compared to 77.8% in 2006.

Operating expenses

Research and development. Gross research and development expenses increased by $2.5 million, or 26.9%, to $11.8 million in 2007 from $9.3 million in 2006. This increase was primarily attributed to an increase of salaries of approximately $1.4 million, which resulted principally from salary raises and the devaluation of the U.S. dollar relative to the NIS; an increase in depreciation of $0.3 million; and an increase in other expenses, principally consisted of rent and overhead, of approximately $0.8 million. The increase in gross research and development expenses is primarily driven by the development of our NetXplorer management application suite and the Service Gateway platform.

Research and development expenses, net of received and accrued grants from the Office of the Chief Scientist, increased by $1.9 million, or 24.6%, to $9.4 million in 2007 from $7.5 million in 2006. Grants totaled $2.4 million in 2007 compared to $1.8 million in 2006. The increase in grants received was due to a larger grant approved by the Office of the Chief Scientist and the devaluation of U.S. dollar relative to the NIS. Research and development expenses as a percentage of revenues increased to 28.9% in 2007 from 22.1% in 2006.

Sales and marketing. Sales and marketing expenses increased by $2.6 million in 2007, or 16.9%, to $18.1 million in 2007 from $15.5 million in 2006. This increase resulted from growth in salaries and related expenses of $1.9 million, primarily related to hiring of additional sales, marketing and presale support personnel to provide broader geographical coverage and increased focus on the service provider market, an increase of $0.4 million in facilities-related and overhead expenses and an increase of $0.6 million in consulting, travel and other expenses, partially offset by a decrease of $0.3 million in amortization of stock-based compensation. Sales and marketing expenses as a percentage of revenues increased to 55.6% in 2007 from 45.3% in 2006.

General and administrative. General and administrative expenses increased by $2.1 million, or 61.2%, to $5.6 million in 2007 from $3.5 million in 2006. This increase is primarily attributable to: an increase of $1.1 million in professional services expenses primarily associated with corporate governance compliance under the Sarbanes-Oxley Act of 2002 and rules of the U.S. Securities and Exchange Commission and Nasdaq; director and officer liability insurance premiums and defending the class action law suits filed in the United States District Court for the Southern District of New York against us and certain of our directors and officers; an increase of $0.5 million in personnel expenses due to the hiring of additional personnel as well as salary increases; an increase of $0.3 million in other expenses mainly depreciation and travel; and an increase of $0.2 million in amortization of stock-based compensation.

General and administrative expenses as a percentage of revenues increased to 17.2% in 2007 from 10.2% in 2006.

Financial and other income (expenses), net. Financial and other expenses, net were $845,000 in 2007 compared to a net income of $630,000 in 2006. The decrease in financial and other income (expenses), net is primarily due to the $4.9 million impairment charge against our investment in auction-rate securities, and was partially offset by an increase in interest received on cash balances and marketable securities of $3.3 million that is primarily attributable to the increase in cash, cash equivalents and marketable securities as a result of our initial public offering and decrease in interest and other expenses of $0.1 million.

Income tax expense. Income tax expense was $0.5 million in 2007 compared to income tax expense of $0.1 million in 2006. The increase in income tax expense is primarily attributable to a write-down of a withholding tax asset, which resulted from our assessment as to our ability to utilize them in the foreseeable future.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenues

Products. Product revenues increased by $10.3 million, or 56%, to $28.8 million in 2006 from $18.5 million in 2005. The majority of our product revenue in 2006 was derived from sales of the NetEnforcer AC-1000 and AC-2500, which are targeted primarily at large and medium service providers. Product revenues for 2006 also include $6.9 million of sales to a single system integrator compared to $3.7 million of sales to the same system integrator in 2005.

Services. Service revenues increased by $0.9 million, or 20%, to $5.4 million in 2006 from $4.5 million in 2005. The increase in service revenues resulted primarily from a larger product base covered by maintenance and support contracts. The increase in service revenues was partially offset by a decrease of sales of maintenance and support programs related to NetReality's legacy products in 2006 compared to 2005. Service revenues as a percentage of sales decreased in part due to sales to NTL, which, as of December 31, 2006, had not included maintenance and support contracts typically associated with our product sales.

Revenues from products, which comprised 84.2% of our total revenues in 2006, increased by 3.7% compared to 2005, while the balance of our revenues were attributable to service revenues.

Cost of revenues and gross margin

Products. Cost of product revenues increased by $1.9 million, or 44%, to $6.4 million in 2006 from $4.5 million in 2005. This increase resulted primarily from increased expenditure of $1.1 million on materials due to an increased number of units sold, and an increase of $0.4 million in royalty expense accrued or paid to the Office of the Chief Scientist. Product gross margin was 77.6% in 2006 compared to 75.8% in 2005. This increase resulted from higher priced modules accounting for a greater proportion of total sales.

Services. Service cost of revenues increased by $0.3 million, or 24%, to $1.2 million in 2006 from $0.9 million in 2005. This increase resulted from an increase of $0.2 million in post-sales support expenses as a result of employing additional post-sale support engineers and salary increases. Services gross margin was 78.4% in 2006 compared to 79.0% in 2005.

Total gross margin was 77.8% in 2006 compared to 76.4% in 2005.

Operating expenses

Research and development. Gross research and development expenses increased by $2.6 million, or 38.8%, to $9.3 million in 2006 from $6.7 million in 2005. This increase was primarily due to the hiring of additional research and development staff as well as increased salaries. These increases were driven by the development of new products, such as our NetXplorer management application suite and the initial development of our Service Gateway platform.

Research and development expenses, net of received and accrued grants from the Office of the Chief Scientist, increased by $1.6 million, or 27.1%, to $7.5 million in 2006 from $5.9 million in 2005. Grants totaled $1.8 million in 2006 compared to $0.7 million in 2005. The increase in grants received was due to a larger grant approved by the Office of the Chief Scientist. Research and development expenses as a percentage of revenues decreased to 22.1% in 2006 from 25.8% in 2005.

Sales and marketing. Sales and marketing expenses increased by $3.6 million in 2006, or 30.0%, to $15.5 million in 2006 from $11.9 million in 2005. This increase resulted from an increase of $0.9 million due primarily to the hiring of additional sales, marketing and engineering personnel to provide broader geographical coverage and increased focus on the service provider market, an increase of $0.6 million in amortization of stock-based compensation and an increase of $0.3 million in expenses relating to cooperative advertising expenses, public relations and advertising. Sales and marketing expenses as a percentage of revenues decreased to 45.3% in 2006 from 52% in 2005.

General and administrative. General and administrative expenses increased by $1.1 million, or 45.6%, to $3.5 million in 2006 from $2.4 million in 2005. This increase resulted from an increase of $0.2 million due primarily to the hiring of additional personnel as well as salary increases, an increase of $0.2 million in expenses related to professional services and increase of $0.5 million in amortization of stock-based compensation. General and administrative expenses as a percentage of revenues were approximately 10% in 2006 maintaining similar level as in 2005.

Financial and other income (expenses), net. Financial and other income, net was $0.6 million in 2006 compared to $45,000 in 2005. The increase in financial and other income resulted from an increase of $0.6 million related to interest received on cash balances.

Income tax benefit (expense). Income tax expense was $111,000 in 2006 compared to income tax benefit of $218,000 in 2005. The income tax expense in 2006 was attributable to a reversal of deferred income tax asset and taxable income in the U.S. subsidiary.

B. Liquidity and Capital Resources

From inception until consummation of our initial public offering we financed our operations primarily through private placements of our equity securities and, to a lesser extent, through borrowings from financial institutions. Sales of our equity securities including the consummation of our initial public offering resulted in net proceeds to us of approximately $112.7 million, net of issuance expenses.

As of December 31, 2007, we had $28.1 million in cash and cash equivalents and $42.6 million in marketable securities, of which $35.4 million were ARS. As of December 31, 2007, our working capital, which we calculate by subtracting our current liabilities from our current assets, was $37.2 million.

Based on our current business plan, we believe that our existing cash balances, will be sufficient to meet our anticipated cash needs for payments of our recent acquisition of Esphion's business and for working capital and capital expenditures for at least the next twelve months. In addition, we believe that the current lack of liquidity of the ARS will not have a material impact on our liquidity, cash flow or our ability to fund our operations for at least the next twelve months. If our estimates of revenues, expenses 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 acquisition or investment opportunities that may arise in the future, although we currently do not have any specific acquisitions or investments planned.

Operating activities. Net cash used in operating activities in 2007 was $6.1 million. Net cash used in operating activities was primarily attributable to our net loss of $9.9 million and was partially offset by non-cash expenses that primarily consisted of a $4.9 million impairment charge against ARS, $1.5 million in depreciation and amortization and $1.4 million in stock-based compensation expenses. In addition, an increase of $1.9 million in trade receivables, an increase of $1.8 million in other receivables and prepaid expenses, which is primarily attributable to the increase of a receivable from the Office of Chief Scientist, an increase of $1.6 million in inventories balances, a decrease of $1.0 million in trade payables and changes in other balance sheet items, net of $0.4 million, partially offset by the increase of $1.0 million in employees and payroll accruals and an increase of $1.7 million in deferred revenues, caused a further increase of the net cash used in operating activities.

Net cash provided by the operating activities in 2006 was $1.3 million. This net cash was generated primarily from our net income of $0.6 million adjusted for non-cash expenses of $2.3 million and by an increase in trade and other accounts payable of $2.8 million, an increase of $1.1 million in deferred revenues, partially offset by an increase of $2.3 million in trade receivables, an increase of $2.1 million in inventories, and by an increase of $1.1 million in other receivables and prepaid expenses and other assets due to prepaid payments for the lease on our new offices in Hod-Hasharon, Israel. Net cash provided by operating activities in 2005 was $0.2 million and was generated primarily by an increase of $1.3 million in deferred revenues and an increase in trade and other accounts payable of $1.1 million, partially offset by our net loss of $2.4 million adjusted for non-cash expenses of $0.9 million.

Investing activities. Net cash provided by investing activities in 2007 was $25.6 million, primarily due to redemption and sale of available-for-sale marketable securities in the amount of $115.7 million, partially offset by investment in available-for-sale marketable securities in the amount of $87.1 million, and $3.0 million of capital investment primarily in research and development equipment. Net cash used in investing activities in 2006 was $73.9 million and consisted primarily of $104.1 million investments in available-for-sale marketable securities, partially offset by $32.5 million of redemption and sales of available-for-sale marketable securities, $2.1 million of capital investments primarily in research and development equipment and $0.3 million of investment in severance pay funds. Net cash used in investing activities in 2005 was $0.4 million and consisted primarily of $0.7 million of capital investments primarily in research and development equipment, $4.3 million investments in available-for-sale marketable securities, partially offset by $4.6 million of redemption and sales of available-for-sale marketable securities.

We expect that our capital expenditures will total approximately $2.0 million in 2008. We anticipate that these capital expenditures will be primarily related to further investments in research and development equipment of our next generation products and in leasehold improvements.

Financing activities. Net cash provided by financing activities in 2007 was $1.5 million and was generated primarily by the issuance of share capital through stock options and warrant exercise. Net cash provided by financing activities in 2006 was $76.1 million and was primarily attributable to the net funds raised in our initial public offering of $70.5 million, issuance of share capital prior to our initial public offering of $5.4 million and other issuances of share capital due to options and warrants exercise including related stock based compensation tax benefits of $0.2 million. Net cash used in financing activities in 2005 was $0.1 million resulting primarily from the repayment of $0.2 million of indebtedness partially offset by funds received from option exercises.

C. Research and Development, Patents and Licenses

Our research and development activities take place in Israel and New Zealand. As of December 31, 2007, 89 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.

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

Total research and development expenses, before royalty bearing grants, were approximately $6.7 million, $9.3 million and $11.8 million in the years ended December 31, 2005, 2006 and 2007, respectively. Royalty bearing grants amounted to $0.7 million, $1.8 million and $2.4 million in 2005, 2006 and 2007, respectively.

D. Trend Information

See "ITEM 5: Operating and Financial Review and Prospects" above.

E. Off Balance Sheet Arrangements

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

F. Contractual and Other Commitments

The following table of our material contractual and other obligations known to us as of December 31, 2007, summarizes the aggregate effect that these obligations are expected to have on our cash flows in the periods indicated. We currently estimate that we may be required to pay an aggregate of $0.5 to $0.8 million in earnout payments to be accrued in 2008.

	Payments due by period				
Contractual Obligations	**Total**	**Less than 1 year**	**1– 3 years**	**3-5 years**	**Over 5 years**
	(in thousands of U.S. dollars)				
Operating leases — offices(1)	$ 2,737	$ 645	$ 1,424	$ 668	$ –
Operating leases — vehicles	1,471	857	614	–	–
Purchase obligations	1,900	1,900	–	–	–
Accrued severance pay(2)	3,175	–	–	–	3,175
Total	$ 9,283	$ 3,402	$ 2,038	$ 668	$ 3,175

(1) Consists primarily of an operating lease for our facilities in Hod-Hasharon, Israel, as well as operating leases for facilities leased by our subsidiaries.

(2) Accrued severance pay relates to obligations to our Israeli employees as required under Israeli labor laws. These obligations are payable, among others, upon termination, retirement or death of the respective employee.

ITEM 6: Directors, Senior Management and Employees

A. Directors and Senior Management

Our directors and executive officers, their ages and positions as of June 15, 2008, are as follows:

Name	Age	Position
Directors		
Yigal Jacoby	47	Chairman of the Board
Rami Hadar	44	Director, Chief Executive Officer and President
Yossi Sela(1)	56	Director
Dr. Eyal Kishon(1)(2)	48	Director
Shai Saul(1)	45	Director
Nurit Benjamini(1)(2)	41	Director
Steven D. Levy(2)	52	Director
Executive Officers		
Amir Weinstein(3)	47	Executive Vice President — Products and Technology
Anat Shenig	39	Vice President — Human Resources
Andrei Elefant	34	Vice President — Product Management and Marketing
Doron Arazi	44	Chief Financial Officer
Elazar (Azi) Ronen	46	Executive Vice President — Corporate Development
Eli Cohen	40	Vice President — International Sales
Jay Klein	43	Vice President — Chief Technology Officer
Pini Gvili	42	Vice President — Operations
Ramy Moriah	52	Vice President — Customer Care and Information Technology
Vin Costello	51	Vice President and General Manager — The Americas

(1) Member of our compensation and nomination committee.
(2) Member of our audit committee.
(3) Mr. Weinstein has resigned his position to be effective as of September 1, 2008.

Directors

Yigal Jacoby co-founded our company in 1996 and serves as Chairman of our board of directors. Prior to co-founding Allot, Mr. Jacoby served as General Manager of Bay Network’s Network Management Division in Santa Clara from 1996 to 1997. In 1992, he founded Armon Networking, a manufacturer of RMON-based network management solutions, which was sold to Bay Networks in 1996. He also held various engineering and marketing management positions at Tekelec, a manufacturer of Telecommunication monitoring and diagnostic equipment, including Director, OSI & LAN Products from 1989 to 1992 and Engineering Manager from 1987 to 1989. Mr. Jacoby has founded several startups in the communications field and served on their boards. Mr. Jacoby has a B.A., cum laude, in Computer Science from Technion — Israel Institute of Technology and an M.Sc. in Computer Science from University of Southern California.

Rami Hadar has served as our Chief Executive Officer and President since 2006 and is a member of our board of directors. Prior to joining us, Mr. Hadar founded CTP Systems, a developer of cordless telephony systems in 1989 and served as Chief Executive Officer until its acquisition by DSP Communications in 1995. Mr. Hadar continued with DSP Communication’s executive management team for two years, and thereafter, in 1999, the company was acquired by Intel. In 1997, Mr. Hadar co-founded Ensemble Communications, a pioneer in the broadband wireless space and the WiMax standard, where he served as Executive Vice President of Sales and Marketing until 2002. Mr. Hadar also served as Chief Executive Officer of Native Networks from 2002 to 2005, which was successfully sold and integrated to Alcatel. Mr. Hadar holds a B.Sc. in Electrical Engineering from Technion — Israel Institute of Technology.

Yossi Sela has served as a director since 1998. Mr. Sela is the Managing Partner of Gemini Israel Funds, a leading Venture Capital fund, which invests primarily in seed and early stage Israeli technology companies. In this capacity, Mr. Sela sits on the board of a number of Gemini portfolio companies, including Adimos Inc., Saifun Semiconductors Ltd., and IXI Mobile, Ltd. Mr. Sela's past board positions include CommTouch Software Ltd., Precise Software Solutions Ltd. and Envara Inc. In 1995, he served as the Chief Executive Officer of Ornet Data Communication Technologies Ltd., which was a Gemini portfolio company. Mr. Sela led that company until its acquisition by Siemens AG in September 1995. From 1990 to 1992, Mr. Sela served as Vice President of Marketing at DSP Group, an American-Israeli company specializing in proprietary Digital Signal Processing for consumer and telecommunication applications. He later served as VP Marketing at DSP Communications, Inc., a spin-off of DSP Group. From 1985 to 1989, Mr. Sela worked at Daisy Systems Inc. where he was Director for CAD Development and PCB Marketing Manager for Europe. From 1974 to 1984, he served in the Israel Defense Forces and was responsible for the definition and development of systems for communication applications. Mr. Sela holds a B.Sc. in Electrical Engineering from the Technion — Israel Institute of Technology and an M.B.A. from Tel Aviv University.

Dr. Eyal Kishon has served as a director since 1998. In 1996, Dr. Kishon co-founded Genesis Partners, an Israeli technology-driven venture capital fund, and currently serves as Founder and Managing Partner. From 1993 to 1996, Dr. Kishon served as the Associate Director of the Polaris Fund, now Pitango. Prior to that, Dr. Kishon served as Chief Technology Officer at Yozma Venture Capital from 1992 to 1993. From 1991 to 1992, he worked at the IBM Research Center, and from 1989 to 1991 he worked at the AT&T Bell Laboratories' Robotics Research Department. Dr. Kishon also serves as a director of AudioCodes Ltd. (NASDAQ: AUDC) and Celtro Inc. He holds a Ph.D. in Computer Science and Robotics from the Courant Institute of Mathematical Sciences at New York University and a B.A. in Computer Science from the Technion — Israel Institute of Technology. Dr. Kishon has written a number of scientific publications and holds a patent for signature verification for interactive security systems.

Shai Saul has served as a director since 2000. Mr. Saul is currently Managing General Partner of Tamir Fishman Ventures. During 2001, he acted as interim-CEO for CopperGate Communications. From 1994 to 1999, Mr. Saul acted as Executive Vice President for Aladdin Knowledge Systems Ltd. (NASDAQ: ALDN), a leading provider of digital security solutions. From 1993 to 1994, he served as Chief Executive Officer of Ganot Ltd. Mr. Saul also serves as Chairman of the Board of CopperGate Communications and as member of the board of Lanoptics Ltd. (NASDAQ: LNOP). Mr. Saul holds an LL.B. from Tel Aviv University.

Nurit Benjamini has served as an outside director since 2007. Ms. Benjamini has served as the Chief Financial Officer of CopperGate Communications, a system-on-chip company that develops markets and sells chipsets for the home networking and MDU/MTU Broadband Access markets, since 2007. Previously, Ms. Benjamini served as the Chief Financial Officer of Compugen Ltd. (NASDAQ: CGEN) from 2000 to 2007. Prior to her position with Compugen Ltd., from 1998 to 2000, Ms. Benjamini served as the Chief Financial Officer of Phone-Or Ltd. Between 1993 and 1998, Ms. Benjamini served as the Chief Financial Officer of Aladdin Knowledge Systems Ltd. (NASDAQ: ALDN). Ms. Benjamini holds a B.A. in Economics and Business and an M.B.A. in Finance, both from Bar Ilan University, Israel.

Steven D. Levy has served as an outside director since 2007. Mr. Levy served as a Managing Director and Global Head of Communications Technology Research at Lehman Brothers from 1998 to 2005. Before joining Lehman Brothers, Mr. Levy was a Director of Telecommunications Research at Salomon Brothers from 1997 to 1998, Managing Director and Head of the Communications Research Team at Oppenheimer & Co. from 1994 to 1997 and a senior communications analyst at Hambrecht & Quist from 1986 to 1994. Mr. Levy has served as a director of PCTEL, a broadband wireless technology company since January 2006 and of Zhone Technologies, Inc., a U.S. provider of telecommunications equipment, since April 2006. Mr. Levy holds a B.Sc. in Materials Engineering and an M.B.A., both from the Rensselaer Polytechnic Institute.

Executive Officers

Amir Weinstein joined our company in 2005 and has served as our Executive Vice President — Products and Technology since then. Prior to that, in 1999, Mr. Weinstein co-founded Business Layers, now Netegrity, a provisioning company, providing workflow and IT provisioning solutions to enterprises, and held the position of General Manager until 2004. Mr. Weinstein has held several other senior management positions, including Vice President of Engineering at Nortel Networks, a phone and data communication company from 1996 to 1999. Amir holds a B.Sc. in Computer Science and Mathematics from Bar Ilan University and M.Sc. in Computer Science from UCLA.

Anat Shenig joined our company in 2000 and has served as Vice President — Human Resources since 2007. Ms. Shenig is responsible for human resources recruiting, welfare policy and employees' training. Prior to joining us, Ms. Shenig served as Human Resource Manager for Davidoff insurance company and as an organizational consultant for Aman Consulting. Ms. Shenig holds bachelor degrees in Psychology and Economics from Tel Aviv University and an M.B.A. in organizational behavior from Tel Aviv University.

Andrei Elefant joined our company in 2000 and has served as VP Product Management since 2007. Mr. Elefant assumed responsibility to our marketing activities in 2008. Mr. Elefant is responsible for product management, product marketing and strategic project management. Prior to joining us, Mr. Elefant served as officer in the Israeli air force. Mr. Elefant holds a B.Sc. in Mechanical Engineering from the Technion — Israel Institute of Technology and an M.B.A. from Tel-Aviv University.

Doron Arazi has served as our Chief Financial Officer since 2007. Prior to joining us, Mr. Arazi held various financial positions at Verint Systems Ltd., one of the largest subsidiaries of Verint System Inc., an analytic software-based solutions provider. For the last three years, Mr. Arazi has served as Vice President Finance of Verint Systems Ltd. Mr. Arazi is a certified public accountant and he holds a B.A. in Accounting and Economics and an M.B.A. from Tel Aviv University.

Eli Cohen has served as our Vice President International Sales since 2008. Prior to joining us, from 2006 through 2008, Mr. Cohen was general manager of the Access Line business and before that the Vice President of Sales and Sales Operations for the Broadband Access Division at ECI Telecom, a supplier of networking infrastructure for carriers and service provider networks. Previously, Mr. Cohen held various senior positions in sales and marketing from 2002 to 2006 at ECI. Before that, between 1999 and 2002, Mr. Cohen was CEO and Director of Sales & Marketing of GigaSpaces Technologies, an e-commerce start-up company in the field of infrastructure for business and residential applications. Mr. Cohen has a B.Sc. in Electronic Engineering from Coventry University and an M.B.A. from Manchester University.

Elazar (Azi) Ronen has served as our Executive Vice President — Corporate Development since 2005 and served as Executive Vice President — Technology and Marketing from 1999 to 2005. Prior to joining us, from 1998 through 1999, Mr. Ronen was the Vice President of Marketing at VocalTec Communications, a vendor of VoIP networking equipment. Previously, Mr. Ronen was the Vice President of Research and Development at RADLINX, a member of the RAD group, a vendor of remote access servers and fax over IP networking equipment from 1990 to 1998. Mr. Ronen has a B.Sc., cum laude, in Computer Sciences from the Technion — Israel Institute of Technology.

Jay Klein joined our company in 2006 and has served as VP and CTO since 2007. Mr. Klein is responsible for driving our technology strategy, expanding our core algorithmic competence and driving intellectual property development, industry standards involvement and academic cooperation. Prior to joining us, between 2004 and 2006, Mr. Klein served as VP at DSPG (VoIP and multimedia silicon solutions) where he was responsible for strategic technology acquisitions. Between 1997 and 2003, Mr. Klein was Co-Founder and CTO of Ensemble Communications, a wireless access systems manufacturer and was one of the founders and creators of WiMAX and IEEE 802.16. Prior to that, between 1993 and 1997, he served as CTO and VP of R&D at CPT Systems, a cellular systems manufacturer, which was acquired by DSP Communications and later by Intel. Mr. Klein holds a B.Sc. in Electrical and Electronic Engineering from Tel-Aviv University.

Pini Gvili has served as our Vice President — Operations since 2006. Prior to joining us, from 2004 to 2006, he served as Vice President Operations for Celerica, a start-up company specializing in solutions for cellular network optimization. From 2001 to 2004, Mr. Gvili was the Vice President — Operations and IT at Terayon Communication Systems, and from 1998 to 2000, held the position of Manager of Integration and Final Testing at Telegate. Mr. Gvili was also a hardware/software engineer at Comverse/Efrat, a world leader of voice mail and digital recording systems, from 1994 to 1997. Mr. Gvili has a B.Sc. in Computer Science from Champlain University and was awarded a practical electronics degree from ORT Technical College.

Ramy Moriah has served as our Vice President — Customer Care & IT since 2005. Prior to joining us, Mr. Moriah was a founding member of Daisy System’s Design Center in Israel, in 1984. From 1991 to 1994, Mr. Moriah held the position of Manager of Software Development at Orbot Instruments, a world leader of Automatic Optical Inspection manufacturer for the VLSI Chip Industry. Mr. Moriah was also the acting General Manager at ACA, 3D CAD/solid modeling software for architecture from 1995 to 1997, and served there as Vice President — Research and Development from 1995 to 1997. Mr. Moriah holds a B.Sc., cum laude, in Computer Engineering from the Technion — Israel Institute of Technology and an M.Sc. in Management and Information Systems from the Tel Aviv University School of Business Administration.

Vin Costello has served as VP and & General Manager – Americas since 2006. Mr. Costello began his career with NYNEX and rapidly rose through the ranks achieving the title of Vice President, Business Network Solutions and Vice President Global Sales. Mr. Costello founded and headed NYNEX Network Integration and upon the merger with Bell Atlantic, was named President and CEO of Bell Atlantic Network Integration. Mr. Costello departed Verizon for an optical networking start-up where he served as VP of Sales and assisted Corvis Corporation, in their successful initial public offering. Mr. Costello was subsequently named VP and General Manager of the Managed Storage Division after Corvis purchased Broadwing and reinvented itself as a service provider. Mr. Costello holds a B.Sc. in Computer Applications and Information Systems as well as Business Management (double major) from New York University and earned an M.Sc. in Telecommunications and Computing Management from Polytechnic University.

B. Compensation of Officers and Directors

The aggregate compensation paid to or accrued on behalf of our directors and executive officers as a group during 2007 consisted of approximately $2.3 million in salary, fees, bonus, commissions and directors' fees and approximately $377,000 in amounts set aside or accrued to provide pension, retirement or similar benefits, but excluding amounts we expended for automobiles made available to our officers, expenses, including dues for professional and business associations, business travel and other expenses, and other benefits commonly reimbursed or paid by companies in Israel.

We pay each of our outside directors an annual fee of $10,000, paid in four equal installments of $2,500, at the beginning of each calendar quarter with respect to the preceding quarter (with a pro-rata payment for the first and last calendar quarters of service, to the extent the outside director did not serve as such during the entire calendar quarter). Each outside director also was granted upon his or her election options to purchase 15,000 of our ordinary shares, which vest on a quarterly basis over a period of three years.

During 2007, our officers and directors received, in the aggregate, options to purchase 440,000 ordinary shares under our equity based compensation plans. These options have a weighted average exercise price of approximately $8.76 and the options will expire ten years after the date the options were granted.

C. Board Practices

Corporate Governance Practices

As a foreign private issuer, we are permitted under Nasdaq Marketplace Rule 4350 to follow Israeli corporate governance practices instead of the Nasdaq Global Market requirements, provided we disclose which requirements we are not following and the equivalent Israeli requirement. We must also provide Nasdaq with a letter from outside counsel in our home country, Israel, certifying that our corporate governance practices are not prohibited by Israeli law.

We rely on this “foreign private issuer exemption” with respect to the following items:

- We follow the requirements of Israeli law with respect to the quorum requirement for meetings of our shareholders, which are different from the requirements of Rule 4350(f). Under our articles of association, the quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person, by proxy or by written ballot, who hold or represent between them at least 25% of the voting power of our shares, instead of 33 1/3% of the issued share capital provided by under the Nasdaq Global Market requirements. This quorum requirement is based on the default requirement set forth in the Israeli Companies Law, 1999, or the Companies Law. We submitted a letter from our outside counsel in connection with this item prior to our initial public offering in November 2006.
- We do not seek shareholder approval for equity compensation plans in accordance with the requirements of the Companies Law, which does not fully reflect the requirements of Rule 4350(i)(1)(A). Under Israeli law, we may amend our 2006 Incentive Compensation Plan by the approval of our board of directors, and without shareholder approval as is generally required under rule 4350(i)(1)(A). Under Israeli law, the adoption and amendment of equity compensation plans, including changes to the reserved shares, do not require shareholder approval. We submitted a letter from our outside counsel in connection with this item in June 2008.

We otherwise comply with the Nasdaq Global Market rules requiring that listed companies have a majority of independent directors and maintain a compensation and nominating committee composed entirely of independent directors. We are also subject to Israeli corporate governance requirements applicable to companies incorporated in Israel whose securities are listed for trading on a stock exchange outside of Israel.

We may in the future provide Nasdaq with an additional letter or letters notifying Nasdaq that we are following our home country practices, consistent with the Israeli Companies Law and practices, in lieu of other requirements of Marketplace Rule 4350.

Board of Directors

Terms of Directors

Our current board of directors consists of seven directors, each of whom was appointed by a certain group of shareholders pursuant to rights of appointment granted in our previous articles of association, except for Mr. Hadar, who serves on our board of directors by virtue of his position as Chief Executive Officer and the outside directors, Ms. Benjamini and Mr. Levy, who were elected by our shareholders in 2007. Our articles of association provide that we may have not less than five directors and up to nine directors. The members of our board of directors do not receive any additional remuneration upon termination of their services as directors.

Under our articles of association our directors (other than the outside directors, whose appointment is required under the Companies Law; see “—Outside Directors”) are divided into three classes. Each class of directors consists, as nearly as possible, of one-third of the total number of directors constituting the entire board of directors (other than the outside directors). At each annual general meeting of our shareholders, the election or re-election of directors following the expiration of the term of office of the directors of that class of directors, will be for a term of office that expires on the third annual general meeting following such election or re-election, such that each year the term of office of only one class of directors will expire. Yossi Sela who is a Class I director, will hold office until our annual meeting of shareholders to be held in 2010. Class II directors, consisting of Dr. Eyal Kishon and Shai Saul, will hold office until our annual meeting of shareholders to be held in 2008. Class III directors, consisting of Yigal Jacoby and Rami Hadar, will hold office until our annual meeting of shareholders to be held in 2009. The directors shall be elected by a vote of the holders of a majority of the voting power present and voting at that meeting. Each director, will hold office until the annual general meeting of our shareholders for the year in which his term expires and until his successor is elected and qualified, unless the tenure of such director expires earlier pursuant to the Companies Law or unless he is removed from office as described below.

Under our articles of association the approval of a special majority of the holders of at least 75.0% of the voting rights present and voting at a general meeting is generally required to remove any of our directors from office. The holders of a majority of the voting power present and voting at a meeting may elect directors in their stead or fill any vacancy, however created, in our board of directors. In addition, vacancies on our board of directors, other than vacancies created by an outside director, may be filled by a vote of a simple majority of the directors then in office. A director so chosen or appointed will hold office until the next annual general meeting of our shareholders, unless earlier removed by the vote of a majority of the directors then in office prior to such annual meeting. See "—Outside Directors" for a description of the procedure for election of outside directors.

Outside Directors

Qualifications of Outside Directors

Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel that are "public companies," which also includes companies with shares listed on the Nasdaq Global Market, are required to appoint at least two outside directors.

A person may not serve as an outside director if at the date of the person's appointment or within the prior two years, the person, the person's relatives, entities under the person's control, or the person's partners or employer, have or had any affiliation with us or any entity controlled by or under common control with us during the prior two years, or which controls us at the time of such person's appointment.

The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder, excluding service as a director in a private company prior to the first offering of its shares to the public if such director was appointed as a director of the private company in order to serve as an outside director following the public offering.

The term relative is defined as spouses, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of each of these persons.

The term office holder is defined as a director, general manager, chief business manager, deputy general manager, vice general manager, executive vice president, vice president, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions, without regard to such person's title. Each person listed under "—Directors and Senior Management" is an office holder.

No person can serve as an outside director if the person's position or other business create, or may create, a conflict of interests with the person's responsibilities as a director or may otherwise interfere with the person's ability to serve as a director. If at the time an outside director is appointed all current members of the board of directors are of the same gender, then that outside director must be of the other gender.

The Companies Law provides that each outside director must meet certain professional qualifications or have financial and accounting expertise, and that at least one outside director must have financial and accounting expertise. However, if at least one of our directors meets the independence requirements of the Securities Exchange Act of 1934, as amended, and the standards of the Nasdaq Global Market rules for membership on the audit committee and also has financial and accounting expertise as defined in the Companies Law and applicable regulations, then our outside directors are required to meet the professional qualifications only. Under applicable regulations, a director with financial and accounting expertise is a director who, by reason of his or her education, professional experience and skill, has a high level of proficiency in and understanding of business accounting matters and financial statements. He or she must be able to thoroughly comprehend the financial statements of the company and initiate debate regarding the manner in which financial information is presented. The regulations define a director with the requisite professional qualifications as a director who satisfies one of the following requirements: (1) the director holds an academic degree in either economics, business administration, accounting, law or public administration, (2) the director either holds an academic degree in any other field or has completed another form of higher education in the company's primary field of business or in an area which is relevant to the office of an outside director, or (3) the director has at least five years of cumulative experience serving in one or more of the following capacities: (a) a senior business management position in a corporation with a substantial scope of business, (b) a senior position in the company's primary field of business or (c) a senior position in public administration.

Until the lapse of two years from termination of office, a company may not engage an outside director to serve as an office holder and cannot employ or receive professional services for payment from that person, either directly or indirectly, including through a corporation controlled by that person.

Election of Outside Directors

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

- the majority of shares voted at the meeting, including at least one-third of the shares of non-controlling shareholders voted at the meeting, excluding abstentions, vote in favor of the election of the outside director; or

- the total number of shares of non-controlling shareholders voted against the election of the outside director does not exceed one percent of the aggregate voting rights in the company.

For a company such as ours, the initial term of an outside director is three years and may be extended for additional three-year terms by the shareholders, if certain conditions are met. An outside director can be removed from office only by the same majority of shareholders that is required to elect an outside director, or by a court (if the outside director ceases to meet the statutory qualifications with respect to his or her appointment, or if he or she violates his or her duty of loyalty to the company). Each committee of a company's board of directors which is authorized to exercise the board of directors' authorities is required to include at least one outside director, except for the audit committee, which is required to include all outside director.

An outside director is entitled to compensation as provided in regulations promulgated under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with services provided as an outside director.

Nasdaq Requirements

Under the rules of the Nasdaq Global Market, a majority of directors must meet the definition of independence contained in those rules. Our board of directors has determined that all of our directors, other than Yigal Jacoby and Rami Hadar, meet the independence standards contained in the rules of the Nasdaq Global Market. We do not believe that any of these directors have a relationship that would preclude a finding of independence under these rules and, in reaching its determination, our board of directors determined that the other relationships that these directors have with us do not impair their independence.

Audit Committee

Companies Law Requirements

Under the Companies Law, the board of directors of any public company must also appoint an audit committee comprised of at least three directors including all of the outside directors, but excluding the:

- chairman of the board of directors;
- controlling shareholder or a relative of a controlling shareholder; and
- any director employed by the company or who provides services to the company on a regular basis.

Nasdaq Requirements

Under the Nasdaq Global Market rules, we are required to maintain an audit committee consisting of at least three independent directors, all of whom are financially literate and one of whom has accounting or related financial management expertise. Our audit committee members are required to meet additional independence standards, including minimum standards set forth in rules of the Securities and Exchange Commission and adopted by the Nasdaq Global Market.

Approval of Transactions with Office Holders and Controlling Shareholders

The approval of the audit committee is required to effect specified actions and transactions with office holders and controlling shareholders. The term controlling shareholder means a shareholder with the ability to direct the activities of the company, other than by virtue of being an office holder. A shareholder is presumed to be a controlling shareholder if the shareholder holds 50.0% or more of the voting rights in a company or has the right to appoint the majority of the directors of the company or its general manager. For the purpose of approving transactions with controlling shareholders, the term also includes any shareholder that holds 25.0% or more of the voting rights of the company if the company has no shareholder that owns more than 50.0% of its voting rights. For purposes of determining the holding percentage stated above, two or more shareholders who have a personal interest in a transaction that is brought for the company's approval are deemed as joint holders. The audit committee may not approve an action or a transaction with a controlling shareholder or with an office holder unless at the time of approval two outside directors are serving as members of the audit committee and at least one of them was present at the meeting at which the approval was granted.

Audit Committee Role

Our board of directors has adopted an audit committee charter setting forth the responsibilities of the audit committee consistent with the rules of the Securities and Exchange Commission and The Nasdaq Global Market rules, which include:

- retaining and terminating the company's independent auditors, subject to shareholder ratification;
- pre-approval of audit and non-audit services provided by the independent auditors; and
- approval of transactions with office holders and controlling shareholders, as described above, and other related-party transactions.

Additionally, under the Companies Law, the role of the audit committee is to identify irregularities in the business management of the company in consultation with the internal auditor or the company's independent auditors and suggest an appropriate course of action to the board of directors and to approve the yearly or periodic work plan proposed by the internal auditor to the extent required. The audit committee charter states that in fulfilling this role the committee is entitled to rely on interviews and consultations with our management, our internal auditor and our independent auditor, and is not obligated to conduct any independent investigation or verification.

Our audit committee consists of our directors, Ms. Nurit Benjamini, Mr. Steven Levy and Dr. Eyal Kishon. The financial expert on the audit committee pursuant to the definition of the Securities and Exchange Commission is Ms. Benjamini.

Compensation and Nominating Committee

We have established a compensation and nominating committee consisting of our directors, Mr. Yossi Sela, Dr. Eyal Kishon, Ms. Nurit Benjamini and Mr. Shai Saul. This committee also oversees matters related to our corporate governance practices. Our board of directors has adopted a compensation and nominating committee charter setting forth the responsibilities of the committee consistent with the Nasdaq Global Market rules, which include:

- determining the compensation of our Chief Executive Officer and other executive officers;
- granting options to our employees and the employees of our subsidiaries;
- recommending candidates for nomination as members of our board of directors; and
- developing and recommending to the board corporate governance guidelines and a code of business ethics and conduct in accordance with applicable laws.

Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is, among other things, to examine whether a company’s actions comply with applicable law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an interested party or an office holder or a relative of an interested party or an office holder, nor may the internal auditor be the company’s independent auditor or the representative of the same. An interested party is defined in the Companies Law as a holder of 5.0% or more of the issued share capital or voting power in a company, any person or entity who has the right to designate one director or more or the chief executive officer of the company or any person who serves as a director or as a chief executive officer. In February 2007, our board of directors approved the appointment of the firm of Haikin, Rubin, Cohen & Gilboa as the internal auditor of the Company.

Exculpation, Insurance and Indemnification of Office Holders

Under the Companies Law, a company may not exculpate an office holder from liability for a breach of the duty of loyalty. However, a company may approve an act performed in breach of the duty of loyalty of an office holder provided that the office holder acted in good faith, the act or its approval does not harm the company, and the office holder discloses the nature of his or her personal interest in the act and all material facts and documents a reasonable time before discussion of the approval. An Israeli company may exculpate an office holder in advance from liability to the company, in whole or in part, for damages caused to the company as a result of a breach of duty of care but only if a provision authorizing such exculpation is inserted in its articles of association. Our articles of association include such a provision. An Israeli company may not exculpate a director for liability arising out of a prohibited dividend or distribution to shareholders.

An Israeli company may indemnify an office holder in respect of certain liabilities either in advance of an event or following an event provided a provision authorizing such indemnification is inserted in its articles of association. Our articles of association contain such an authorization. An undertaking provided in advance by an Israeli company to indemnify an office holder with respect to a financial liability imposed on him or her in favor of another person pursuant to a judgment, settlement or arbitrator's award approved by a court must be limited to events which in the opinion of the board of directors can be foreseen based on the company's activities when the undertaking to indemnify is given, and to an amount or according to criteria determined by the board of directors as reasonable under the circumstances, and such undertaking shall detail the above mentioned events and amount or criteria. In addition, a company may undertake in advance to indemnify an office holder against the following liabilities incurred for acts performed as an office holder:

- reasonable litigation expenses, including attorneys' fees, incurred by the office holder as a result of an investigation or proceeding instituted against him or her by an authority authorized to conduct such investigation or proceeding, provided that (i) no indictment was filed against such office holder as a result of such investigation or proceeding; and (ii) no financial liability, such as a criminal penalty, was imposed upon him or her as a substitute for the criminal proceeding as a result of such investigation or proceeding or, if such financial liability was imposed, it was imposed with respect to an offense that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, incurred by the office holder or imposed by a court in proceedings instituted against him or her by the company, on its behalf or by a third party or in connection with criminal proceedings in which the office holder was acquitted or as a result of a conviction for an offense that does not require proof of criminal intent.

An Israeli company may insure an office holder against the following liabilities incurred for acts performed as an office holder if and to the extent provided in the company's articles of association:

- a breach of duty of loyalty to the company, to the extent that the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach of duty of care to the company or to a third party, including a breach arising out of the negligent conduct of the office holder; and
- a financial liability imposed on the office holder in favor of a third party.

An Israeli company may not indemnify or insure an office holder against any of the following:

- a breach of duty of loyalty, except to the extent that the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach of duty of care committed intentionally or recklessly, excluding a breach arising out of the negligent conduct of the office holder;
- an act or omission committed with intent to derive illegal personal benefit; or
- a fine or forfeit levied against the office holder.

Under the Companies Law, exculpation, indemnification and insurance of office holders must be approved by our audit committee and our board of directors and, in respect of our directors, by our shareholders.

Our articles of association allow us to indemnify and insure our office holders to the fullest extent permitted by the Companies Law. Our office holders are currently covered by a directors and officers' liability insurance policy. In May 2007, we and certain of our officers and directors were named as defendants in a number of purported securities class action lawsuits filed in the United States District Court for the Southern District of New York and that were consolidated to "*In re Allot Communications Ltd. Securities Litigation.*" under Master File No. 07-cv-03455 (RJH). See "ITEM 8: Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings." As of the date of this annual report, no other claims for directors and officers' liability insurance have been filed under our policies and we are not aware of any pending or threatened litigation or proceeding involving any of our directors or officers in which indemnification is sought.

We have entered into agreements with each of our directors and office holders exculpating them, to the fullest extent permitted by law, from liability to us for damages caused to us as a result of a breach of duty of care, and undertaking to indemnify them to the fullest extent permitted by law. This indemnification is limited to events determined as foreseeable by the board of directors based on our activities, and to an amount or according to criteria determined by the board of directors as reasonable under the circumstances, and the insurance is subject to our discretion depending on its availability, effectiveness and cost. The current maximum amount set forth in such agreements is the greater of (1) with respect to indemnification in connection with a public offering of our securities, the gross proceeds raised by us and/or any selling shareholder in such public offering, and (2) with respect to all permitted indemnification, including a public offering of our securities, an amount equal to 50% of the our shareholders' equity on a consolidated basis, based on our most recent financial statements made publicly available before the date on which the indemnity payment is made.

In the opinion of the U.S. Securities and Exchange Commission, however, indemnification of directors and office holders for liabilities arising under the Securities Act is against public policy and therefore unenforceable.

D. Employees

As of December 31, 2007, we had 242 employees of whom 174 were based in Israel, 29 in the United States and the remainder in Asia and Europe. The breakdown of our employees by department is as follows:

	December 31,		
Department	**2005**	**2006**	**2007**
Manufacturing and operations	14	19	19
Research and development	75	95	89
Sales, marketing, service and support	80	95	102
Management and administration	15	27	32
Total	184	236	242

Under applicable Israeli law, we and our employees are subject to protective labor provisions such as restrictions on working hours, minimum wages, minimum vacation, sick pay, severance pay and advance notice of termination of employment as well as equal opportunity and anti-discrimination laws. Orders issued by the Israeli Ministry of Industry, Trade and Labor make certain industry-wide collective bargaining agreements applicable to us. These agreements affect matters such as cost of living adjustments to salaries, length of working hours and week, recuperation, travel expenses, and pension rights. Our employees are not represented by a labor union. We provide our employees with benefits and working conditions which we believe are competitive with benefits and working conditions provided by similar companies in Israel. We have never experienced labor-related work stoppages and believe that our relations with our employees are good.

E. Share Ownership

Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of June 15, 2008, of each of our directors and executive officers.

Name of Beneficial Owner	Number of Shares Beneficially Held(1)	Percent of Class
Directors		
Shai Saul(2)	2,337,843	10.6%
Dr. Eyal Kishon(3)	2,034,760	9.2%
Yigal Jacoby(4)	1,817,674	7.9%
Yossi Sela(5)	1,708,929	7.7%
Rami Hadar	272,963	1.2%
Nurit Benjamini	*	*
Steven D. Levy	*	*
Executive Officers		
Amir Weinstein	215,811	1.0%
Anat Shenig	*	*
Andrei Elefant	*	*
Doron Arazi	*	*
Elazar (Azi) Ronen	*	*
Eli Cohen	*	*
Jay Klein	*	*
Pini Gvili	*	*
Ramy Moriah	*	*
Vin Costello	*	*
All directors and executive officers as a group	8,552,483	38.4%

* Less than one percent of the outstanding ordinary shares.

(1) As used in this table, “beneficial ownership” means the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security. For purposes of this table, a person is deemed to be the beneficial owner of securities that can be acquired within 60 days from June 15, 2008 through the exercise of any option or warrant. Ordinary shares subject to options or warrants that are currently exercisable or exercisable within 60 days are deemed outstanding for computing the ownership percentage of the person holding such options or warrants, but are not deemed outstanding for computing the ownership percentage of any other person. The amounts and percentages are based upon 22,061,347 ordinary shares outstanding as of June 15, 2008.

(2) Consists of 2,331,593 shares held by the Tamir Fishman Ventures and an option to purchase 6,250 shares held by Shai Saul. Mr. Saul is a managing partner of Tamir Fishman and, by virtue of his position, may be deemed to have voting and investment power, and thus beneficial ownership, with respect to the shares held by the Tamir Fishman Ventures. Mr. Saul disclaims such beneficial ownership except to the extent of his pecuniary interest therein.

(3) Consists of 2,028,510 shares held by the Genesis Group and an option to purchase 6,250 shares held by Dr. Eyal Kishon. Dr. Kishon is a managing partner of Genesis Partners and, by virtue of his position, may be deemed to have voting and investment power, and thus beneficial ownership, with respect to the shares held by the Genesis Group. Dr. Kishon disclaims such beneficial ownership except to the extent of his pecuniary interest therein.

(4) Consists of 835,410 shares held by Odem Rotem Holdings Ltd., a company wholly-owned and controlled by Yigal Jacoby, 1,500 shares held by Anat Jacoby, who is Yigal Jacoby's spouse, and an option to purchase 481,794 shares held by Odem Rotem Holdings. Also consists of options held directly by Mr. Jacoby to purchase 222,491 shares and a right held by Mr. Jacoby to purchase 246,479 shares currently held by a trustee. See "ITEM 7: Major Shareholders and Related Party Transactions—Related Party Transactions—Escrow Agreement with Yigal Jacoby."

(5) Consists of 1,702,679 shares held by the Gemini Group and an option to purchase 6,250 shares held by Yossi Sela. Mr. Sela is a managing partner of Gemini Israel Funds and, by virtue of his position, may be deemed to have voting and investment power, and thus beneficial ownership, with respect to the shares held by the Gemini Group. Mr. Sela disclaims such beneficial ownership except to the extent of his pecuniary interest therein.

Our directors and executive officers hold, in the aggregate, options exercisable into 2,495,541 ordinary shares. The 2,495,541 options have a weighted average exercise price of approximately $3.43 per share and have expiration dates until 2018.

Share Option Plans

We have adopted four share option plans and, as of June 1, 2008, we had 3,961,817 ordinary shares reserved for issuance under these plans, with respect to which (i) options to purchase 3,724,603 ordinary shares at a weighted average exercise price of $4.08 per share were outstanding, and (ii) options to purchase 1,748,128 ordinary shares were already exercised by certain of the grantees and such shares were issued by us. As of June 1, 2008, options to purchase 1,785,021 ordinary shares were vested and exercisable.

We will only grant options or other equity incentive awards under the 2006 Incentive Compensation Plan, although previously-granted options will continue to be governed by our other plans.

2006 Incentive Compensation Plan

The 2006 plan is intended to further our success by increasing the ownership interest of certain of our and our subsidiaries' employees, directors and consultants and to enhance our and our subsidiaries' ability to attract and retain employees, directors and consultants.

The number of ordinary shares that we may issue under the 2006 plan will increase on the first day of each fiscal year during the term of the 2006 plan, in each case in an amount equal to the lesser of (i) 1,000,000 shares, (ii) 3.5% of our outstanding ordinary shares on the last day of the immediately preceding year, or (iii) an amount determined by our board of directors. The number of shares subject to the 2006 plan is also subject to adjustment if particular capital changes affect our share capital. Ordinary shares subject to outstanding awards under the 2006 plan or our 2003 plan or 1997 plans that are subsequently forfeited or terminated for any other reason before being exercised will again be available for grant under the 2006 plan. As of June 1, 2008, options or other awards to purchase 1,656,399 ordinary shares had been granted under the 2006 plan and 237,214 remained available for future options or other awards.

Israeli participants in the 2006 plan may be granted options subject to Section 102 of the Israeli Income Tax Ordinance. Section 102 of the Israeli Income Tax Ordinance, allows employees, directors and officers, who are not controlling shareholders and are considered Israeli residents to receive favorable tax treatment for compensation in the form of shares or options. Our non-employees service providers and controlling shareholders may only be granted options under another section of the Tax Ordinance, which does not provide for similar tax benefits. Section 102 includes two alternatives for tax treatment involving the issuance of options or shares to a trustee for the benefit of the grantees and also includes an additional alternative for the issuance of options or shares directly to the grantee. The most favorable tax treatment for the grantees is under Section 102(b)(2) of the Tax Ordinance, the issuance to a trustee under the "capital gain track." However, under this track we are not allowed to deduct an expense with respect to the issuance of the options or shares. Any stock options granted under the 2006 plan to participants in the United States will be either "incentive stock options," which may be eligible for special tax treatment under the Internal Revenue Code of 1986, or options other than incentive stock options (referred to as "nonqualified stock options"), as determined by our compensation and nominating committee and stated in the option agreement.

Our compensation and nominating committee administers the 2006 plan and it will select which of our and our subsidiaries' and affiliates' eligible employees, directors and/or consultants shall receive options or other awards under the 2006 plan and will determine the terms of the grant, including, exercise prices, method of payment, vesting schedules, acceleration of vesting and the other matters necessary in the administration of the plan.

If we undergo a change of control, as defined in the 2006 plan, subject to any contrary law or rule, or the terms of any award agreement in effect before the change of control, (a) the compensation and nominating committee may, in its discretion, accelerate the vesting, exercisability and payment, as applicable, of outstanding options and other awards; and (b) the compensation and nominating committee, in its discretion, may adjust outstanding awards by substituting ordinary shares or other securities of any successor or another party to the change of control transaction, or cash out outstanding options and other awards, in any such case, generally based on the consideration received by our shareholders in the transaction.

Allot Communications Ltd. Key Employee Share Incentive Plan (2003)

Our 2003 share option plan provides for the grant of options to our and our affiliates' employees, directors, officers, consultants, advisers and service providers. As of June 1, 2008, there were outstanding options to purchase 2,169,664 ordinary shares under the plan, of which options to purchase 1,572,337 ordinary shares were vested and exercisable and options to purchase 991,794 ordinary shares were already exercised for ordinary shares. We no longer grant options under this plan, and ordinary shares underlying any option granted under this plan that terminates without exercise become available for future issuance under our 2006 plan.

The terms of the 2003 plan are in compliance with Section 102 of the Israeli Income Tax Ordinance, which allows employees, directors and officers, who are not controlling shareholders and are considered Israeli residents to receive favorable tax treatment for compensation in the form of shares or options. Our non-employees service providers and controlling shareholders may only be granted options under another section of the Tax Ordinance, which does not provide for similar tax benefits.

We have elected to issue our options under the capital gain track and, accordingly, all options granted under this plan to Israeli residents have been granted under the capital gain track. Section 102 also provides for an income tax track, under which, among other things, the benefits to the employees would be taxed as ordinary income, we would be allowed to recognize expenses for tax purposes and the minimum holding period for the trustee will be twelve months from the end of the calendar year in which such options are granted, and if granted after January 1, 2006, twelve months after the date of grant. In order to comply with the terms of the capital gain track, all options, as well as the ordinary shares issued upon exercise of these options and other shares received subsequently following any realization of rights with respect to such options, such as stock dividends and stock splits are granted to a trustee and should be held by the trustee for the lesser of thirty months from the date of grant, or two years following the end of the tax year in which the options were granted and if granted after January 1, 2006 only two years after the date of grant. Under this plan, all options, whether or not granted pursuant to said Section 102, the ordinary shares issued upon their exercise and other shares received subsequently following any realization of rights are issued to a trustee.

The plan is administered by our board of directors which has delegated certain responsibilities to our compensation and nomination committee.

In the event of our being acquired by means of merger with or into another entity, in which our outstanding shares are exchanged for securities or other consideration issued, or caused to be issued, by the acquiring company or its subsidiary, or in the event of the sale of all or substantially all of our assets, to the extent it has not been previously exercised, each vested or unvested option will terminate immediately prior to the consummation of such transaction. The plan further provides that, in the event of our consolidation or merger with or into another corporation, the compensation committee may, in its absolute discretion and without obligation, agree that instead of termination: (i) each unexercised option, if possible, will be assumed or an equivalent option will be substituted by our successor corporation or a parent or subsidiary of our successor corporation; or (ii) we will pay to the grantee an amount equivalent to the valuation of the grantee's unexercised options on an as converted basis at that time.

Allot Communications Ltd. Key Employees Share Incentive Plan and Key Employees of Subsidiaries and Consultants Share Incentive Plan (1997)

Our Key Employees Share Incentive Plan, adopted in 1997, provides for the grant of options to any of our directors, officers and employees, and our Key Employees of Subsidiaries and Consultants Share Incentive Plan, also adopted in 1997, provides for the grant of options to any of our or our subsidiaries' directors, officers, employees, or consultants. The terms of both plans are identical, except that the grant of options under the first plan was made in compliance with the provisions of Section 102 of the Tax Ordinance, as was in effect in 1997 and prior to its amendments in 2003, which allows employees who are considered Israeli residents to receive favorable tax treatment.

As of June 1, 2008, there were outstanding options to purchase 9,737 ordinary shares under the two plans, all of which were vested and options to purchase 9,737 ordinary shares that were already exercised for ordinary shares. We no longer grant options under these plans, and ordinary shares underlying any option granted under these plans that terminate without exercise become available for future issuance under our 2006 plan.

The plans are administered by our compensation and nominating committee.

ITEM 7: Major Shareholders and Related Party Transactions

A. Major Shareholders

The following table sets forth certain information regarding the beneficial ownership of our outstanding ordinary shares as of June 15, 2008, by each person who we know beneficially owns 5.0% or more of the outstanding ordinary shares. Each of our shareholders has identical voting rights with respect to its shares. All of the information with respect to beneficial ownership of the ordinary shares is given to the best of our knowledge.

	Ordinary Shares Beneficially Owned(1)	Percentage of Ordinary Shares Beneficially Owned
Brookside Capital Fund(2)	3,426,638	15.5%
Tamir Fishman Ventures(3)	2,337,843	10.6%
Genesis Partners(4)	2,034,760	9.2%
Yigal Jacoby(5)	1,817,674	7.9%
Gemini Group(6)	1,708,929	7.8%
Partech International Group(7)	1,280,562	5.8%

(1) As used in this table, "beneficial ownership" means the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security. For purposes of this table, a person is deemed to be the beneficial owner of securities that can be acquired within 60 days from June 15, 2008 through the exercise of any option or warrant. Ordinary shares subject to options or warrants that are currently exercisable or exercisable within 60 days are deemed outstanding for computing the ownership percentage of the person holding such options or warrants, but are not deemed outstanding for computing the ownership percentage of any other person. The amounts and percentages are based upon 22,061,347 ordinary shares outstanding as of June 15, 2008.

(2) Based on a Schedule 13G/A filed on January 9, 2008. Consists of 3,426,638 shares held by Brookside Capital Partners Fund, L.P., a Delaware limited partnership. Brookside Capital Investors, L.P., a Delaware limited partnership is the sole general partner of the Brookside Capital Partners Fund, L.P. Brookside Capital Management, LLC, a Delaware limited liability company, is the sole general partner of Brookside Capital Investors, L.P. Domenic J. Ferrante is the sole managing member of Brookside Capital Management, LLC. The address of the Brookside entities and the foregoing individual is 111 Huntington Avenue, Boston, Massachusetts 02199.

(3) Based on a Schedule 13G/A filed on February 14, 2008. Consists of 1,165,014 shares held by Tamir Fishman Ventures II L.P., 804,842 shares held by Tamir Fishman Venture Capital II Ltd., 155,904 shares held by Tamir Fishman Ventures II (Israel) L.P., 138,310 shares held by Tamir Fishman Ventures II (Cayman Islands) L.P., 54,543 shares held by Tamir Fishman Ventures II CEO Funds (U.S.) L.P., 12,980 shares held by Tamir Fishman Ventures II CEO Funds L.P. and an option to purchase 6,250 shares held by Shai Saul. Tamir Fishman Ventures II, LLC is the sole general partner of each of the foregoing limited partnerships and has management rights over the shares held by Tamir Fishman Venture Capital II Ltd. by virtue of a management agreement with Tamir Fishman Ventures II, LLC. The managing members of Tamir Fishman Ventures II, LLC are Shai Saul, Michael Elias and Tamir Fishman & Co. Ltd. Eldad Tamir and Danny Fishman are Co-Presidents and Co-Chief Executive Officers of Tamir Fishman & Co. Ltd. and, by virtue of their positions, may be deemed to be beneficial owners of the securities held thereby. Each of the foregoing entities and individuals disclaims beneficial ownership of these securities except to the extent of its or his pecuniary interest therein. The address of the Tamir Fishman entities and the foregoing individuals is 21 Haarbaa, Tel Aviv 64739 Israel.

(4) Based on a Schedule 13G filed on February 14, 2007. Consists of 1,312,770 shares held by Genesis Partners I L.P., 715,740 shares held by Genesis Partners (Cayman) L.P. and an option to purchase 6,250 shares held by Dr. Eyal Kishon. Eddy Shalev and Dr. Kishon are the directors of E. Shalev Management Ltd., a general partner of these funds. These individuals each have voting, investment and dispositive power with respect to the shares held by the Genesis entities and may be deemed to be beneficial owners of the securities held thereby. Each individual disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. The address of the Genesis entities and the foregoing individuals is 11 HaMenofim Street, Herzliya Pituach 46725, Israel.

(5) Based on a Schedule 13G/A filed on February 20, 2008. Consists of 30,000 ordinary shares personally held by Yigal Jacoby, 1,500 ordinary shares held jointly by Yigal Jacoby and his wife, Anat Jacoby. Also consists of options held directly by Mr. Jacoby to purchase 222,491 shares and a right held by Mr. Jacoby to purchase 246,479 shares currently held by a trustee. Also consists of 835,410 shares held by Odem Rotem Holdings Ltd., a company wholly-owned and controlled by Mr. Jacoby, and an option to purchase 481,794 shares held by Odem Rotem Holdings. The address of Mr. Jacoby is 22 Hanagar Street, Neve Ne'eman Industrial Zone B, Hod-Hasharon 45240, Israel. The address of Odem Rotem Holdings Ltd. and Anat Jacoby is 9 Nordau Street, Rannana, Israel.

(6) Based on a Schedule 13G/A filed on February 14, 2008. Consists of 880,295 shares held by Gemini Israel II L.P., 690,669 shares held by Gemini Israel II Parallel Fund L.P., 112,216 shares held by Advent PGGM Gemini L.P., 19,499 shares held by Gemini Partner Investors L.P. and an option to purchase 6,250 shares held by Yossi Sela. Mr. Sela is a managing partner and a shareholder of Gemini Israel Funds Ltd., the sole general partner or the sole general partner of the general partner of Gemini Israel II L.P., Gemini Israel II Parallel Fund L.P., Advent PGGM Gemini L.P., Gemini Partner Investors L.P., Gemini Israel III L.P. and Gemini Israel III Parallel Fund L.P. The board of directors of Gemini Israel Funds Ltd. has sole investment control with respect to these entities and is comprised of Steve Kahn, Amram Rasiel, Dr. A.I. (Ed) Mlavsky, Yossi Sela and David Cohen. These individuals share voting power over the shares and held by the Gemini entities and may be deemed to be the beneficial owners of the securities held thereby. Each individual disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. The address of the Gemini entities and the foregoing individuals is 9 HaMenofim Street, Herzliya Pituach 46725, Israel.

(7) Based on a Schedule 13G/A filed on February 14, 2008. Consists of 469,537 shares held by Partech International Growth Capital I LLC, 533,565 shares held by Partech International Growth Capital III LLC, 224,098 shares held by AXA Growth Capital II L.P., 32,016 shares held by Double Black Diamond II LLC and 21,346 shares held by Multinvest LLC. 46th Parallel, LLC is the managing member of each of Partech International Growth Capital I, LLC and Partech International Growth Capital III, LLC. 48th Parallel, LLC is the general partner of AXA Growth Capital II L.P. ParVenture Japan Managers, LLC is the managing member of Multinvest, LLC. Thomas G. McKinley and Vincent Worms are the managing members of Double Black Diamond II, LLC. PAR SF, LLC is the managing member of each of 46th Parallel, LLC and 48th Parallel, LLC. Vincent Worms and Vendome Capital, LLC are the managing members of each of PAR SF, LLC and ParVenture Japan Managers, LLC. Thomas G. McKinley is the managing member of Vendome Capital, LLC. Thomas G. McKinley and Vincent Worms share voting power over the shares held by the Partech International Group and may be deemed to be the beneficial owners of the securities held thereby. Each individual disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. The address of the Partech International entities and the foregoing individuals is 50 California Street, Suite 3200, San Francisco, California.

Significant Changes in the Ownership of Major Shareholders

As of June 15, 2008, Brookside Capital Partners Fund, L.P. was the beneficial owner of 3,426,638, or 15.5%, of our ordinary shares. As of December 31, 2007, Brookside Capital Partners was the beneficial owner of 2,204,921. 10.5%. As of December 31, 2006, Brookside Capital Partners was not a major shareholder.

Record Holders

Based on a review of the information provided to us by our transfer agent, as of June 15, 2008, there were 46* record holders of ordinary shares, of which 13 represented United States* record holders holding approximately 67% of our outstanding ordinary shares.

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* Including the Depository Trust Company.

B. Related Party Transactions

Our policy is to enter into transactions with related parties on terms that, on the whole, are no more favorable, or no less favorable, than those available from unaffiliated third parties. Based on our experience in the business sectors in which we operate and the terms of our transactions with unaffiliated third parties, we believe that all of the transactions described below met this policy standard at the time they occurred.

Registration Rights

We have entered into an amended and restated investors rights agreement with certain of our shareholders, pursuant to which holders of 13,275,813 ordinary shares are entitled to certain registration rights as described below. This amount does not include shares issuable upon the exercise of options and warrants, which are also entitled to registration rights as described under "— Registration Rights—Certain Options and Warrants." In accordance with such agreement, the following entities which beneficially own more than 5.0% of our ordinary shares, are entitled to registration rights: the Tamir Fishman Ventures; the Gemini Group; the Genesis Group; the Partech International Group; and our Chairman, Yigal Jacoby and Odem Rotem Holdings, a company wholly-owned and controlled by Mr. Jacoby.

Demand registration rights. We are required to file a registration statement in respect of ordinary shares held by our former preferred shareholders as follows:

- two registrations at the request of one or more of our shareholders holding ordinary shares representing in the aggregate a majority of ordinary shares resulting from conversion of our Series A preferred shares, Series B preferred shares, collectively, referred to as the B Registrable Securities, and Series C preferred shares and all ordinary shares issued in respect of such shares;
- one registration at the request of one of more of our shareholders holding ordinary shares representing in the aggregate a majority of ordinary shares resulting from conversion of our Series D preferred shares and all ordinary shares issued in respect of such shares;
- one registration at the request of one of more of our shareholders holding ordinary shares representing in the aggregate a majority of ordinary shares resulting from conversion of our Series E preferred shares and all ordinary shares issued in respect of such shares; and
- provided that (1) the aggregate proceeds from any such registration are estimated in good faith to be in excess of $5.0 million and (2) we are not required to effect a registration within 180 days after the effective date of our initial public offering or a registration statement for any subsequent offering.

Following a request to effect a registration by our shareholders as described above, we are required to offer the other shareholders that are entitled to registration rights an opportunity to include their shares in the registration statement. In the event that the managing underwriter advises the registering shareholders in writing that marketing factors require a limitation on the number of shares that can be included in the registration statement, certain preferences will apply with respect to the inclusion of the registrable securities.

Registration on Form F-3. Shareholders holding registrable securities may request that we register such registrable securities on Form F-3, provided that each such registration generates proceeds of at least $2.0 million. This right may be exercised up to twice in any twelve-month period. We are required to give notice of any such request to the other holders of registrable securities and offer them an opportunity to include their shares in the registration statement. In the event that the managing underwriter advises in writing that marketing factors require a limitation on the number of shares that can be included in the registration statement, the shares will be included in the registration statement in an agreed order of preference between the shareholders holding registrable securities.

Piggyback registration rights. Shareholders holding registrable securities also have the right to request that we include their registrable securities in any registration statements filed by us in the future for the purposes of a public offering, subject to specified exceptions. In the event that the managing underwriter advises in writing that marketing factors require a limitation on the number of shares that can be included in the registration statement, the shares will be included in the registration statement in an agreed order of preference between the shareholders holding registrable securities.

Termination. All registration rights granted to holders of registrable securities will terminate on the fifth anniversary of the closing of our initial public offering and, with respect to any of our holders of registrable securities, when the shares held by such shareholder can be sold within a ninety-day period under Rule 144.

Expenses. We will pay all expenses in carrying out the above registrations.

Certain options and warrants. We have also granted the following registration rights to holders of certain warrants and options to purchase our preferred shares:

- 68,713 ordinary shares issuable upon the non-cashless exercise of warrants granted to an Israeli bank and 73,069 ordinary shares that were issued to that Israeli bank pursuant to a cashless exercise of warrants are entitled to the same registration rights as the B Registrable Securities, subject to first cutback as to the B Registrable Securities.
- 163,665 ordinary shares that were issued to an affiliate of another Israeli bank are entitled to notice of and inclusion in any registration statement that we file following our initial public offering. This right terminates with respect to 102,291 of such shares if they can be sold within a 180-day period under Rule 144.
- 246,479 ordinary shares that have been issued, but are held in trust for the benefit of our Chairman, Yigal Jacoby, pending his payment of the purchase price of such shares, will be entitled, upon the payment of the purchase price, to the same registration rights as the Series A preferred shares.

Agreements with Directors and Officers

Employment of Yigal Jacoby. In October 2006, we entered into an agreement with Yigal Jacoby governing the terms of his employment with us for the provision of management and guidance services with regard to our strategy, long term vision and key objectives. Under the terms of the agreement, Mr. Jacoby is required to devote 75% of his time to his position with us. The agreement contains standard employment provisions, including provisions relating to confidentiality and assignment of inventions. We may terminate Mr. Jacoby's employment on thirty days' prior notice, or we may terminate Mr. Jacoby's employment without notice if we give him thirty days' pay in lieu of notice. As of February 2008, Mr. Jacoby waives approximately 65% of his salary under the agreement.

Prior to his transition to a direct employment relationship, Mr. Jacoby provided substantially identical services to us pursuant to a consulting agreement, dated December 2001. The agreement was terminated in October 2006. The agreement contained standard confidentiality provisions that survived the agreement's termination.

In August 2004, we entered into a non-competition agreement with Mr. Jacoby and Odem Rotem Holdings. Under this agreement, Mr. Jacoby and Odem Rotem Holdings are prohibited during the term of Mr. Jacoby's engagement with us and for a period of twelve months thereafter from directly or indirectly competing with our products or services or directly or indirectly soliciting our employees or consultants to engage in business which competes with our products or services. The non-competition agreement does, however, permit Mr. Jacoby, if he becomes an executive of a venture capital fund in the future to serve as a director of the venture capital fund's portfolio companies. Further, any employment or solicitation of our employees or consultants or solicitation of business opportunities by a company in which Odem Rotem Holdings or Mr. Jacoby are a director or shareholders are not be deemed, by itself, to violate the non-competition agreement so long as neither Odem Rotem Holdings nor Mr. Jacoby were actively involved in such employment or solicitation.

Escrow Agreement with Yigal Jacoby. A right to purchase 246,479 ordinary shares was granted to Mr. Jacoby in connection with our Series A financing. The shares are issued, but are held in trust for the benefit of the Mr. Jacoby pursuant to an escrow agreement entered into on January 28, 1998, amended on October 26, 2006, by and among the Company, Mr. Jacoby and an escrow agent. Pursuant to the terms of this agreement, the escrow agent is holding such shares for which Mr. Jacoby has paid nominal value. While these shares are held in trust, neither Mr. Jacoby nor the trustee has voting or economic rights with respect to such shares. Mr. Jacoby may exercise his right to purchase the shares in trust, in whole or in part, by paying any portion of the full $600,000 purchase price (less $475 previously paid in respect of the nominal value of the shares) for the respective portion of the shares. Mr. Jacoby has the right to pay any portion of the purchase price for the respective portion of shares by "net payment" of his right to purchase. Mr. Jacoby's right to purchase expires upon November 15, 2008. See Note 8b(3) to our consolidated financial statements for additional information.

Consulting Agreement with Hess MarkITing Ltd. In June 2005, we entered into a consulting agreement with Hess MarkITing Ltd., as consultant, for consulting services to be determined. This agreement was terminated in May 2008. All of the consulting service under that agreement were to be provided through Sharon Hess, our former Vice President — Marketing and the founder and owner of Hess MarkITing Ltd. The agreement contained a non-compete provision prohibiting the consultant from directly or indirectly having any connection with a business or venture that competes with us. Under the agreement, we paid Hess MarkITing a monthly consulting fee, provided use of one of our company cars and granted stock options to purchase our ordinary shares to Ms. Hess. Such monthly consulting fee was recorded as a sales and marketing expense.

Technical Training Services Agreement with Experteam. We have received technical writing services from Experteam Ltd., a company owned and controlled by the wife of our Chairman, Yigal Jacoby. We began using Experteam in 2004 and our expenses incurred in connection with the engagement of Experteam were approximately $14,000 in 2005, $78,000 in 2006 and $36,000 in 2007.

Employment Agreements. We have entered into employment agreements with each of our officers who work for us as employees. These agreements all contain provisions standard for a company in our industry regarding noncompetition, confidentiality of information and assignment of inventions. The enforceability of covenants not to compete in Israel is limited.

Exculpation, Indemnification and Insurance. Our articles of association permit us to exculpate, indemnify and insure our office holders to the fullest extent permitted by the Companies Law. We have entered into agreements with each of our office holders, exculpating them from a breach of their duty of care to us to the fullest extent permitted by law and undertaking to indemnify them to the fullest extent permitted by law, to the extent that these liabilities are not covered by insurance. See “ITEM 6: Directors, Senior Management and Employees—Board Practices—Exculpation, Insurance and Indemnification of Office Holders.”

C. Interests of experts and counsel

Not applicable.

ITEM 8: Financial Information

A. Consolidated Financial Statements and Other Financial Information.

Consolidated Financial Statements

For our audited consolidated financial statements for the year ended December 31, 2007, please see pages F-2 to F-36 of this report.

Export Sales

See “ITEM 5: Operating and Financial Review and Prospects” under the caption “Geographic Breakdown of Revenues” for certain details of export sales for the last three fiscal years.

Legal Proceedings

On May 1, 2007, a securities class action complaint, *Brickman Investment Inc. v. Allot Communications Ltd. et al.*, was filed in the United States District Court for the Southern District of New York. A number of substantially similar complaints were filed in the same court after the original action was filed. We and certain of our directors and officers are named as defendants. The securities class action complaints allege that the defendants violated Sections 11 and 15 of the Securities Act of 1933 by making false and misleading statements and omissions in our registration statement for our initial public offering in November 2006. The claims are purportedly brought on behalf of persons who purchased our stock pursuant to and/or traceable to the initial public offering on or about November 15, 2006 through April 2, 2007. The plaintiffs seek unspecified compensatory damages against the defendants, as well as attorney's fees and costs. Motions for consolidation and for appointment of lead plaintiff were filed on July 2, 2007 and were decided on March 27, 2008, with an order granting consolidation and appointing co-lead plaintiffs. The Consolidated Amended Compliant was served on June 9, 2008. We have not responded to the complaints, and expect to respond on or about August 10, 2008. We believe that we have meritorious defenses to the pleaded claims. We intend to vigorously defend against those claims.

We may, from time to time in the future be involved in legal proceedings in the ordinary course of business.

Dividends

We have never declared or paid any cash dividends on our ordinary shares and we do not anticipate paying any cash dividends on our ordinary shares in the future. We currently intend to retain all future earnings to finance our operations and to expand our business. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including future earnings, capital requirements, financial condition and future prospects and other factors our board of directors may deem relevant.

B. Significant Changes

Since the date of our audited financial statements included elsewhere in this annual report, there have not been any significant changes in our financial position.

ITEM 9: The Offer and Listing

Not applicable, except for Items 9.A.4 and 9.C, which are detailed below.

Stock Price History

Our ordinary shares began trading publicly on November 16, 2006. Prior to that date, there was no public market for our ordinary shares. The following table lists the high and low closing sale prices for our ordinary shares for the periods indicated as reported by The Nasdaq Global Market.

Year	High	Low
2006	$ 13.81	$ 10.10
2007	11.50	4.35

	High	Low
2006		
Fourth Quarter	$ 13.81	$ 10.10
2007		
First Quarter	$ 11.50	$ 8.42
Second Quarter	8.31	6.45
Third Quarter	8.06	5.63
Fourth Quarter	6.96	4.35
2008		
First Quarter	$ 4.85	$ 2.24
Most Recent Six Months		
May 2008	$ 3.46	$ 3.10
April 2008	3.54	2.50
March 2008	2.90	2.24
February 2008	4.00	2.80
January 2008	4.85	3.97
December 2007	4.85	4.35

Markets

Our ordinary shares have been quoted on The Nasdaq Global Market under the symbol "ALLT" since November 16, 2006.

ITEM 10: Additional Information

A. Share Capital

Not applicable.

B. Memorandum of Association and Articles of Association

Memorandum and Articles of Association

We are registered with the Israeli Registrar of Companies in Jerusalem. Our registration number is 51-239477-6.

A description of our memorandum and articles of association was previously provided in our registration statement on Form F-1 (Registration Statement 333-138313) filed with the Securities and Exchange Commission on October 31, 2006, and is incorporated herein by reference.

Acquisitions under Israeli Law

Full Tender Offer. A person wishing to acquire shares of a public Israeli company and who would as a result hold over 90.0% of the target company's issued and outstanding share capital is required by the Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the issued and outstanding shares of the company. A person wishing to acquire shares of a public Israeli company and who would as a result hold over 90.0% of the issued and outstanding share capital of a certain class of shares is required to make a tender offer to all of the shareholders who hold shares of the same class for the purchase of all of the issued and outstanding shares of the same class. If the shareholders who do not accept the offer hold less than 5.0% of the issued and outstanding share capital of the company or of the applicable class, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, a shareholder that had its shares so transferred may, within three months from the date of acceptance of the tender offer, petition the court to determine that tender offer was for less than fair value and that the fair value should be paid as determined by the court. If the shareholders who did not accept the tender offer hold at least 5.0% of the issued and outstanding share capital of the company or of the applicable class, the acquirer may not acquire shares of the company that will increase its holdings to more than 90.0% of the company's issued and outstanding share capital or of the applicable class from shareholders who accepted the tender offer.

Special Tender Offer. The Companies Law provides that an acquisition of shares of a public Israeli company must be made by means of a special tender offer if as a result of the acquisition the purchaser would become a holder of at least 25.0% of the voting rights in the company. This rule does not apply if there is already another holder of at least 25.0% of the voting rights in the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of more than 45.0% of the voting rights in the company, if there is no other shareholder of the company who holds more than 45.0% of the voting rights in the company. These requirements do not apply if the acquisition (i) occurs in the context of a private placement by the company that received shareholder approval, (ii) was from a shareholder holding at least 25.0% of the voting rights in the company and resulted in the acquirer becoming a holder of at least 25.0% of the voting rights in the company or (iii) was from a holder of more then 45.0% of the voting rights in the company and resulted in the acquirer becoming a holder of more than 45.0% of the voting rights in the company. The special tender offer may be consummated only if (a) at least 5.0% of the voting rights attached to the company's outstanding shares will be acquired by the offeror and (b) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

In the event that a special tender offer is made, a company's board of directors is required to express its opinion on the advisability of the offer, or shall abstain from expressing any opinion if it is unable to do so, provided that it gives the reasons for its abstention. An office holder in a target company who, in his or her capacity as an office holder, performs an action the purpose of which is to cause the failure of an existing or foreseeable special tender offer or is to impair the chances of its acceptance, is liable to the potential purchaser and shareholders for damages, unless such office holder acted in good faith and had reasonable grounds to believe he or she was acting for the benefit of the company. However, office holders of the target company may negotiate with the potential purchaser in order to improve the terms of the special tender offer, and may further negotiate with third parties in order to obtain a competing offer.

If a special tender offer was accepted by a majority of the shareholders who announced their stand on such offer, then shareholders who did not announce their stand or who had objected to the offer may accept the offer within four days of the last day set for the acceptance of the offer.

In the event that a special tender offer is accepted, then the purchaser or any person or entity controlling it or under common control with the purchaser or such controlling person or entity shall refrain of making a subsequent tender offer for the purchase of shares of the target company and cannot execute a merger with the target company for a period of one year from the date of the offer, unless the purchaser or such person or entity undertook to effect such an offer or merger in the initial special tender offer.

Merger. The Companies Law permits merger transactions if approved by each party's board of directors and, unless certain requirements described under the Companies Law are met, a certain percentage of each party's shareholders. The board of directors of a merging company is required pursuant to the Companies Law to discuss and determine whether in its opinion there exists a reasonable concern that as a result of a proposed merger, the surviving company will not be able to satisfy its obligations towards its creditors, such determination taking into account the financial status of the merging companies. If the board has determined that such a concern exists, it may not approve a proposed merger. Following the approval of the board of directors of each of the merging companies, the boards must jointly prepare a merger proposal for submission to the Israeli Registrar of Companies.

Under the Companies Law, if the approval of a general meeting of the shareholders is required, merger transactions may be approved by holders of a simple majority of our shares (including the separate vote of each class of shares of the party to the merger which is not the surviving entity) present, in person, by proxy or by written ballot, at a general meeting and voting on the transaction. In determining whether the required majority has approved the merger, if shares of the company are held by the other party to the merger, or by any person holding at least 25.0% of the voting rights or 25.0% of the means of appointing directors or the general manager of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party or by such person, or any person or entity acting on behalf of, related to or controlled by either of them, is sufficient to reject the merger transaction. If the transaction would have been approved but for the separate approval of each class or the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25.0% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders.

Under the Companies Law, each merging company must inform its secured creditors of the proposed merger plans. Creditors are entitled to notice of the merger pursuant to the regulations adopted under the Companies Law. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger, and may further give instructions to secure the rights of creditors.

In addition, a merger may not be completed unless at least fifty days have passed from the date that a proposal for approval of the merger was filed with the Israeli Registrar of Companies and thirty days from the date that shareholder approval of both merging companies was obtained.

Anti-Takeover Measures

Undesignated preferred stock. The Companies Law allows us to create and issue shares having rights different to those attached to our ordinary shares, including shares providing certain preferred or additional rights to voting, distributions or other matters and shares having preemptive rights. We do not have any authorized or issued shares other than ordinary shares. In the future, if we do create and issue a class of shares other than ordinary shares, such class of shares, depending on the specific rights that may be attached to them, may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares will require an amendment to our articles of association which requires the prior approval of a simple majority of our shares represented and voted at a general meeting.

Supermajority voting. Our articles of association require the approval of the holders of at least two thirds of our combined voting power to effect certain amendments to our articles of association.

Classified board of directors. Our articles of association provide for a classified board of directors. See "ITEM 6: Directors, Senior Management and Employees—Board Practices—Term of Directors."

Transfer Agent and Registrar

The transfer agent and registrar for our ordinary shares is American Stock Transfer& Trust Company. Its address is 59 Maiden Lane, New York, New York 10038 and its telephone number is (718)921-8200.

C. Material Contracts

Summaries of the following material contracts and amendments to these contracts are included in this annual report in the places indicated:

Material Contract	Location
Agreement with R.H. Electronics Ltd.	"ITEM 4.B: Information on the Company–Business Overview–Manufacturing."
Agreement with Flextronics (Israel) Ltd.	"ITEM 4.B: Information on the Company–Business Overview–Manufacturing."
Esphion Limited	"ITEM 5: Operating and Financial Review and Prospects–Operating Results–Overview."
Second Amended and Restated Investor Rights Agreement	"ITEM 7. Major Shareholders and Related Party Transactions–Related Party Transactions–Registration Rights."

D. Exchange Controls

In 1998, Israeli currency control regulations were liberalized significantly, so that Israeli residents generally may freely deal in foreign currency and foreign assets, and non-residents may freely deal in Israeli currency and Israeli assets. There are currently no Israeli currency control restrictions on remittances of dividends on the ordinary shares or the proceeds from the sale of the shares provided that all taxes were paid or withheld; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time.

Non-residents of Israel may freely hold and trade our securities. Neither our memorandum of association nor our articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of ordinary shares by non-residents, except that such restrictions may exist with respect to citizens of countries which are in a state of war with Israel. Israeli residents are allowed to purchase our ordinary shares.

E. Taxation

Israeli Tax Considerations and Government Programs

The following is a general discussion only and is not exhaustive of all possible tax considerations. It is not intended, and should not be construed, as legal or professional tax advice and should not be relied upon for tax planning purposes. In addition, this discussion does not address all of the tax consequences that may be relevant to purchasers of our ordinary shares in light of their particular circumstances, or certain types of purchasers of our ordinary shares subject to special tax treatment. Examples of this kind of investor include residents of Israel and traders in securities who are subject to special tax regimes not covered in this discussion. Each individual/entity should consult its own tax or legal advisor as to the Israeli tax consequences of the purchase, ownership and disposition of our ordinary shares.

To the extent that part of the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure that the tax authorities or the courts will accept the views expressed in this section.

The following summary describes the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to holders of our ordinary shares.

General Corporate Tax Structure in Israel

Israeli companies were generally subject to corporate tax at the rate of 29% of their taxable income in 2007. The corporate tax rate is scheduled to decline to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter. However, the effective tax rate payable by a company that derives income from an approved enterprise (as discussed below) may be considerably less.

Tax Benefits and Grants for Research and Development

Israeli tax law allows, under certain conditions, a tax deduction for expenditures, including capital expenditures, for the year in which they are incurred. Expenditures are deemed related to scientific research and development projects, if:

- The expenditures are approved by the relevant Israeli government ministry, determined by the field of research;
- The research and development must be for the promotion of the company; and
- The research and development is carried out by or on behalf of the company seeking such tax deduction.

The amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. No deduction under these research and development deduction rules is allowed if such deduction is related to an expense invested in an asset depreciable under the general depreciation rules of the income Tax Ordinance, 1961. Expenditures not so approved are deductible in equal amounts over three years.

We intend to apply the Office of the Chief Scientist for approval to allow a tax deduction for all research and development expenses during the year incurred. There can be no assurance that our application will be accepted.

Law for the Encouragement of Industry (Taxes), 1969

The Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, provides several tax benefits for industrial companies. We believe that we currently qualify as an “Industrial Company” within the meaning of the Industry Encouragement Law. The Industry Encouragement Law defines “Industrial Company” as a company resident in Israel, of which 90% or more of its income in any tax year, other than of income from defense loans, capital gains, interest and dividend, is derived from an “Industrial Enterprise” owned by it. An “Industrial Enterprise” is defined as an enterprise whose major activity in a given tax year is industrial production activity.

The following corporate tax benefits, among others, are available to Industrial Companies:

- Amortization of the cost of purchased know-how and patents and of rights to use a patent and know-how which are used for the development or advancement of the company, over an eight-year period;
- Accelerated depreciation rates on equipment and buildings;
- Under specified conditions, an election to file consolidated tax returns with additional related Israeli Industrial Companies; and
- Expenses related to a public offering on the Tel Aviv Stock Exchange and, as of January 1, 2003, also on recognized stock markets outside Israel, are deductible in equal amounts over three years.

Under certain tax laws and regulations, an "Industrial Enterprise" may be eligible for special depreciation rates for machinery, equipment and buildings. These rates differ based on various factors, including the date the operations begin and the number of work shifts. An "Industrial Company" owning an approved enterprise may choose between these special depreciation rates and the depreciation rates available to the approved enterprise.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. We can give no assurance that we qualify or will continue to qualify as an "Industrial Company" or that the benefits described above will be available in the future.

Special Provisions Relating to Taxation Under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features, which are material to us, can be generally described as follows:

- Where a company's equity, as calculated under the Inflationary Adjustments Law, exceeds the depreciated cost of its fixed assets (as defined in the Inflationary Adjustments Law), a deduction from taxable income is permitted equal to the excess multiplied by the applicable annual rate of inflation. The maximum deduction permitted in any single tax year is 70% of taxable income, with the unused portion permitted to be carried forward, linked to the Israeli consumer price index. The unused portion that is carried forward may be deducted in full in the following year.
- Where a company's depreciated cost of fixed assets exceeds its equity, then the excess multiplied by the applicable annual rate of inflation is added to the company's ordinary income, provided that the inflation supplement will only be added to the corporate income and not to other sources of income such as capital gains.
- Subject to certain limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the change in the consumer price index.

The Minister of Finance may, with the approval of the Knesset Finance Committee, determine by decree, during a certain fiscal year (or until February 28th of the following year) in which the rate of increase of the Israeli consumer price index would not exceed or did not exceed, as applicable, 3%, that some or all of the provisions of the Inflationary Adjustments Law shall not apply with respect to such fiscal year, or, that the rate of increase of the Israeli consumer price index relating to such fiscal year shall be deemed to be 0%, and to make the adjustments required to be made as a result of such determination.

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

Tax benefits prior the 2005 amendment

The Law for the Encouragement of Capital Investments, 1959, as amended (effective as of April 1, 2005), generally referred to as the Investments Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an "Approved Enterprise". The Investment Center bases its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program.

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

The Investments Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an Approved Enterprise program in the first five years of using the equipment.

Taxable income of a company derived from an Approved Enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income after the commencement of production, and is limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier. This time limitation does not apply to the exemption period described below.

Should we derive income from sources other than the Approved Enterprise during the relevant period of benefits, such income will be taxable at the regular corporate tax rates.

Under certain circumstances (as further detailed below), the benefit period may extend to a maximum of ten years from the commencement of the benefit period.

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company's undistributed income derived from the Approved Enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, after the commencement of production, depending on the geographic location of the Approved Enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The year's limitation does not apply to the exemption period.

A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise(s) during the tax exemption period will be subject to corporate tax in the year the dividend is distributed in respect of the gross amount distributed, at the rate which would have been applicable had the company not elected the alternative package of benefits, (generally 10%-25%, depending on the percentage of the company's ordinary shares held by foreign shareholders). The dividend recipient is subject to withholding tax at the reduced rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. In the event, however, that the company is qualifies as a foreign investors' company, there is no such time limitation. This tax must be withheld by the company at source, regardless of whether the dividend is converted into foreign currency.

Foreign Investor's Company ("FIC")

A company that has an Approved Enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company of which, among other criteria, more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be entitled to the following:

· Extension of the benefit period to up to ten years.

· An additional period of reduced corporate tax liability at rates ranging between 10% and 25%, depending on the level of foreign (that is, non-Israeli) ownership of our shares. Those tax rates and the related levels of foreign investment are as set forth in the following table:

Region A

Rate of Reduced Tax	***Reduced Tax Period***	***Tax Exemption Period***	***Percent of Foreign Ownership***
25	*0 years*	*10 years*	*0-25%*
25	*0 years*	*10 years*	*25-48.99%*
20	*0 years*	*10 years*	*49-73.99%*
15	*0 years*	*10 years*	*74-89.99%*
10	*0 years*	*10 years*	*90-100%*

Region B

Rate of Reduced Tax	***Reduced Tax Period***	***Tax Exemption Period***	***Percent of Foreign Ownership***
25	*1 years*	*6 years*	*0-25%*
25	*4 years*	*6 years*	*25-48.99%*
20	*4 years*	*6 years*	*49-73.99%*
15	*4 years*	*6 years*	*74-89.99%*
10	*4 years*	*6 years*	*90-100%*

Other Regions

Rate of Reduced Tax	*Reduced Tax Period*	*Tax Exemption Period*	*Percent of Foreign Ownership*
25	*5 years*	*2 years*	*0-25%*
25	*8 years*	*2 years*	*25-48.99%*
20	*8 years*	*2 years*	*49-73.99%*
15	*8 years*	*2 years*	*74-89.99%*
10	*8 years*	*2 years*	*90-100%*

· The twelve years limitation period for reduced tax rate of 15% on dividend from the approved enterprise will not apply.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company's effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year's profits to declare dividends.

We currently intend to reinvest any income derived from our Approved Enterprise program and not to distribute such income as a dividend. As of December 31, 2007, we did not generate income under the provision of the new law.

Tax Benefits under the 2005 Amendment

A recent amendment to the Investment Law, generally referred as the 2005 Amendment, effective as of April 1, 2005 has significantly changed the provisions of the Investments Law. The amendment includes revisions to the criteria for investments qualified to receive tax benefits as an Approved Enterprise. The 2005 Amendment applies to new investment programs and investment programs commencing after 2004, and does not apply to investment programs approved prior to December 31, 2004, and therefore to benefits included in any certificate of approval that was granted before the 2005 Amendment came into effect, which will remain subject to the provisions of the Investments Law as they were on the date of such approval.

However, a company that was granted benefits according to Section 51 of the Investments Law (prior the 2005 Amendment) will not be allowed to choose new tax year as a "Year of Election," referred to below, under the 2005 Amendment, for a period of three years from the company's previous Commencement Year (referred to below) under the old Investments Law.

The 2005 Amendment simplifies the approval process for the approved enterprise. According to the 2005 Amendment, only approved enterprises receiving cash grants require the approval of the Investment Center. The Investment Center will be entitled to approve such programs only until December 31, 2007.

As a result of the 2005 Amendment, it is no longer necessary for a company to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Route, and therefore such companies need not apply to the Investment Center for this purpose. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns or by notifying the Israeli Tax Authority within twelve months of the end of that year, provided that its facilities meet the criteria for tax benefits set out by the 2005 Amendment. Such enterprise is referred to as the Benefited Enterprise. Companies are also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the 2005 Amendment. The 2005 Amendment includes provisions attempting to ensure that a company will not enjoy both Government grants and tax benefits for the same investment program.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise, or the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted average of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets at the end of the year before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the Commencement Year, or twelve years from the first day of the Year of Election. The Commencement Year is defined as the later of (a) the first tax year in which a company had derived income for tax purposes from the Beneficiary Enterprise or (b) the year in which a company requested to have the tax benefits apply to the Beneficiary Enterprise – Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

- Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) in respect of the gross amount of the dividend that we may be distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and
- A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is Abundant in Foreign Investment (owned by at least 74% foreign shareholders and has undertaken to invest a minimum sum of $20 million in the Beneficiary Enterprise as defined in the Investments Law) is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The 2005 Amendment changes the definition of "foreign investment" in the Investments Law so that the definition now requires a minimal investment of NIS5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company's outstanding and paid-up share capital exceeds NIS5 million. Such changes to the aforementioned definition will take effect retroactively from 2003.

The 2005 Amendment will apply to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received approval from the Investment Center on or prior to December 31, 2004, in which case the 2005 Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval.

As a result of the 2005 Amendment, tax-exempt income generated under the provisions of the Investments Law, as amended, will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income.

A substantial portion of our taxable operating income is derived from our approved enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program.

Capital Gains Tax on Sales of Our Ordinary Shares

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

Generally, until the 2006 tax year, capital gains tax was imposed on Israeli resident individuals at a rate of 15% on real gains derived on or after January 1, 2003, from the sale of shares in, among others, Israeli companies publicly traded on NASDAQ or on a recognized stock exchange or regulated market in a country that has a treaty for the prevention of double taxation with Israel. This tax rate was contingent upon the shareholder not claiming a deduction for financing expenses in connection with such shares (in which case the gain was generally be taxed at a rate of 25%), and did not apply to: (i) the sale of shares to a relative (as defined in the Israeli Income Tax Ordinance); (ii) the sale of shares by dealers in securities; (iii) the sale of shares by shareholders that report in accordance with the Inflationary Adjustments Law (that were taxed at corporate tax rates for corporations and at marginal tax rates for individuals); or (iv)the sale of shares by shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

As of January 1, 2006, the tax rate applicable to capital gains derived from the sale of shares, whether or not listed on a stock market, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a "material shareholder" at any time during the twelve-month period preceding such sale, that is, such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 25%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Inflationary Adjustments Law (or certain regulations) at the time of publication of the aforementioned amendment to the Tax Ordinance that came into effect on January 1, 2006, in which case the applicable tax rate is 25%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

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

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

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

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

Taxation of Non-Resident Holders of Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. As of 2006, distributions of dividends other than bonus shares, or stock dividends, income tax is withheld at the source at the rate of 20%, 15% for dividends generated by an approved enterprise (if the dividend is distributed during the tax exemption period or within 12 years thereafter. In the event, however, that the company is qualifies as a Foreign Investors’ Company, there is no such time limitation, unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 20%. However, under the Investments Law, dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15%. Furthermore, dividends not generated by an Approved Enterprise (or Benefited Enterprise) paid to a U.S. corporation holding at least 10% of our issued voting power during the part of the tax year which precedes the date of payment of the dividend and during the whole of its prior tax year, are generally taxed at a rate of 12.5%.

United States Federal Income Taxation

The following is a description of the material United States federal income tax consequences of the ownership and disposition of our ordinary shares. This description addresses only the United States federal income tax considerations of holders that are initial purchasers of our ordinary shares pursuant to the offering and that will hold such ordinary shares as capital assets. This description does not address tax considerations applicable to holders that may be subject to special tax rules, including:

- financial institutions or insurance companies;
- real estate investment trusts, regulated investment companies or grantor trusts;
- dealers or traders in securities or currencies;
- tax-exempt entities;
- certain former citizens or long-term residents of the United States;
- persons that will hold our shares through a partnership or other pass-through entity;
- persons that received our shares as compensation for the performance of services;
- persons that will hold our shares as part of a “hedging” or “conversion” transaction or as a position in a “straddle” for United States federal income tax purposes;
- persons whose “functional currency” is not the United States dollar;or
- holders that own directly, indirectly or through attribution 10.0% or more of the voting power or value of our shares.

Moreover, this description does not address the United States federal estate and gift or alternative minimum tax consequences of the acquisition, ownership and disposition of our ordinary shares.

This description is based on the Code, existing, proposed and temporary United States Treasury Regulations and judicial and administrative interpretations thereof, in each case as in effect and available on the date hereof. All of the foregoing are subject to change, which change could apply retroactively and could affect the tax consequences described below.

For purposes of this description, a “U.S.Holder” is a beneficial owner of our ordinary shares that, for United States federal income tax purposes, is:

- a citizen or resident of the United States;
- corporation, or other entity treated as a corporation for U.S.federal income tax purposes, created or organized in or under the laws of the United States or any state thereof, including the District of Columbia;
- an estate the income of which is subject to United States federal income taxation regardless of its source; or
- a trust if such trust has validly elected to be treated as a United States person for United States federal income tax purposes or if (1)a court within the United States is able to exercise primary supervision over its administration and (2)one or more United States persons have the authority to control all of the substantial decisions of such trust.

A “Non-U.S.Holder” is a beneficial owner of our ordinary shares that is neither a U.S.Holder nor a partnership (or other entity treated as a partnership for United States federal income tax purposes).

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

You should consult your tax advisor with respect to the United States federal, state, local and foreign tax consequences of acquiring, owning and disposing of our ordinary shares.

Distributions

Subject to the discussion below under “Passive Foreign Investment Company Considerations,” if you are a U.S.Holder, for United States federal income tax purposes, the gross amount of any distribution made to you, with respect to your ordinary shares before reduction for any Israeli taxes withheld therefrom, other than certain distributions, if any, of our ordinary shares distribute pro rata to all our shareholders, will be includible in your income as dividend income to the extent such distribution is paid out of our current or accumulated earnings and profits as determined under United States federal income tax principles. Subject to the discussion below under “Passive Foreign Investment Company Considerations,” non-corporate U.S.Holders may qualify for the lower rates of taxation with respect to dividends on ordinary shares applicable to long-term capital gains (that is, gains from the sale of capital assets held for more than one year) with respect to taxable years beginning on or before December31, 2010, provided that certain conditions are met, including certain holding period requirements and the absence of certain risk reduction transactions. However, such dividends will not be eligible for the dividends received deduction generally allowed to corporate U.S.Holders. Subject to the discussion below under “Passive Foreign Investment Company Considerations,” to the extent, if any, that the amount of any distribution by us exceeds our current and accumulated earnings and profits as determined under United States federal income tax principles, it will be treated first as a tax-free return of your adjusted tax basis in your ordinary shares and thereafter as capital gain. We do not expect to maintain calculations of our earnings and profits under United States federal income tax principles and, therefore, if you are a U.S. Holder you should expect that the entire amount of any distribution generally will be reported as dividend income to you.

If you are a U.S.Holder, dividends paid to you with respect to your ordinary shares will be treated as foreign source income, which may be relevant in calculating your foreign tax credit limitation. Subject to certain conditions and limitations, Israeli tax withheld on dividends may be deducted from your taxable income or credited against your United States federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends that we distribute generally should constitute "passive category income," or, in the case of certain U.S. Holders, "general category income." A foreign tax credit for foreign taxes imposed on distributions may be denied when you do not satisfy certain minimum holding period requirements. The rules relating to the determination of the foreign tax credit are complex, and you should consult your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to the discussion below under "Backup Withholding Tax and Information Reporting Requirements," if you are a Non-U.S.Holder, you generally will not be subject to United States federal income or withholding tax on dividends received by you on your ordinary shares, unless you conduct a trade or business in the United States and such income is effectively connected with that trade or business.

Sales Exchange or other Disposition of Ordinary Shares

Subject to the discussion below under "Passive Foreign Investment Company Considerations," if you are a U.S.Holder, you generally will recognize gain or loss on the sale, exchange or other disposition of your ordinary shares equal to the difference between the amount realized on such sale, exchange or other disposition and your adjusted tax basis in your ordinary shares. Such gain or loss will be capital gain or loss. If you are a non corporate U.S.Holder, capital gain from the sale, exchange or other disposition of ordinary shares is eligible for the preferential rate of taxation applicable to long-term capital gains, with respect to taxable years beginning on or before December31, 2010, if your holding period for such ordinary shares exceeds one year (that is, such gain is long-term capital gain). Gain or loss, if any, recognized by you generally will be treated as United States source income or loss for United States foreign tax credit purposes. The deductibility of capital losses for U.S.federal income tax purposes is subject to limitations.

Subject to the discussion below under “Backup Withholding Tax and Information Reporting Requirements,” if you are a Non-U.S.Holder, you generally will not be subject to United States federal income or withholding tax on any gain realized on the sale or exchange of such ordinary shares unless:

- such gain is effectively connected with your conduct of a trade or business in the United States; or
- you are an individual and have been present in the United States for 183days or more in the taxable year of such sale or exchange and certain other conditions are met.

Passive Foreign Investment Company Considerations

A non-U.S. corporation will be classified as a “passive foreign investment company,” or a PFIC, for United States federal income tax purposes in any taxable year in which, after applying certain look-through rules, either:

- at least 75 percent of its gross income is “passive income”; or
- at least 50 percent of the average value of its gross assets (based on the quarterly value of such gross assets) is attributable to assets that produce “passive income” or are held for the production of passive income.

Passive income for this purpose generally includes dividends, interest, royalties, rents, gains from commodities and securities transactions, the excess of gains over losses from the disposition of assets which produce passive income, and includes amounts derived by reason of the temporary investment of funds raised in offerings of our ordinary shares.

Based on our estimated gross income, the average value of our gross assets (the latter determined by reference to the market value of our shares and valuing our intangible assets using the methods prescribed for publicly traded corporations) and the nature of our business, we believe that we would not be classified as a PFIC for the taxable year ended December 31, 2007. However, based on the value of our gross assets determined by reference to the market value of our shares at the end of the first quarter of the 2008 taxable year, there is a substantial risk that we will be classified as a PFIC for the 2008 taxable year. However, because PFIC status is based on our income, assets and activities for the entire taxable year, it is not possible to determine whether we will have become a PFIC for the 2008 taxable year until after the close of the year. Moreover, no rulings have been or will be sought from the U.S. Internal Revenue Service (the “IRS”) with respect to our PFIC status, and no assurance can be given that the IRS or the courts would not reach a contrary conclusion. Our PFIC status should be determined annually based on tests which are factual in nature and our status in future years will depend on our income, assets and activities in those years, although you will be treated as continuing to own an interest in a PFIC if we are a PFIC in any year while you own your shares unless you make certain elections as described further below. While we intend to manage our business so as to avoid PFIC status, to the extent consistent with our other business goals, we cannot predict whether our business plans will allow us to avoid PFIC status determination. Because the market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has been especially volatile, and because that market price may affect the determination of whether we will be considered a PFIC, we cannot assure you that we will not be considered a PFIC for any taxable year. If we were a PFIC, you generally would be subject to imputed interest charges and other disadvantageous tax treatment (including the denial of the taxation of such dividends at the lower rates applicable to long-term capital gains, as discussed above under “Distributions”) with respect to any gain from the sale or exchange of, and excess distributions with respect to, the ordinary shares.

Under the PFIC rules, unless a U.S. Holder makes one of the elections described in the next paragraphs, a special tax regime will apply to both (a) any "excess distribution" by us (generally, the U.S. Holder's ratable portion of distributions in any year which are greater than 125% of the average annual distribution received by such U.S. Holder in the shorter of the three preceding years or the U.S. Holder's holding period) and (b) any gain realized on the sale or other disposition of the ordinary shares. Under this regime, any excess distribution and realized gain will be treated as ordinary income and will be subject to tax as if (a) the excess distribution or gain had been realized ratably over the U.S. Holder's holding period, (b) the amount deemed realized had been subject to tax in each year of that holding period, and (c) the interest charge generally applicable to underpayments of tax had been imposed on the taxes deemed to have been payable in those years. In addition, dividend distributions made to you will not qualify for the lower rates of taxation applicable to long term capital gains discussed above under "Distributions."

Certain elections are available to U.S. Holders of shares that may serve to alleviate some of the adverse tax consequences of PFIC status. If we agreed to provide the necessary information, you could avoid the interest charge imposed by the PFIC rules by making a qualified electing fund, or a QEF election, which election may be made retroactively under certain circumstances, in which case you generally would be required to include in income on a current basis your pro rata share of our ordinary earnings as ordinary income and your pro rata share of our net capital gains as long-term capital gain. We do not expect to provide to U.S. Holders the information needed to report income and gain pursuant to a QEF election, and we make no undertaking to provide such information in the event that we are a PFIC.

Under an alternative tax regime, you may also avoid certain adverse tax consequences relating to PFIC status discussed above by making a mark-to-market election with respect to your ordinary shares annually, provided that the shares are "marketable." Shares will be marketable if they are regularly traded on certain U.S. stock exchanges (including NASDAQ) or on certain non-U.S. stock exchanges. For these purposes, the shares will generally be considered regularly traded during any calendar year during which they are traded, other than in negligible quantities, on at least fifteen days during each calendar quarter.

If you choose to make a mark-to-market election, you would recognize as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the PFIC shares and your adjusted tax basis in the PFIC shares. Losses would be allowed only to the extent of net mark-to-market gain previously included by you under the election for prior taxable years. If the mark-to-market election were made, then the PFIC rules set forth above relating to excess distributions and realized gains would not apply for periods covered by the election. If you make a mark-to-market election after the beginning of your holding period of our ordinary shares, you would be subject to interest charges with respect to the inclusion of ordinary income attributable to the period before the effective date of such election.

Under certain circumstances, ordinary shares owned by a Non-U.S. Holder may be attributed to a U.S. person owning an interest, directly or indirectly, in the Non-U.S. Holder. In this event, distributions and other transactions in respect of such ordinary shares may be treated as excess distributions with respect to such U.S. person, and a QEF election may be made by such U.S. person with respect to its indirect interest in us, subject to the discussion in the preceding paragraphs.

We may invest in stock of non-U.S. corporations that are PFICs. In such a case, provided that we are classified as a PFIC, a U.S. Holder would be treated as owning its pro rata share of the stock of the PFIC owned by us. Such a U.S. Holder would be subject to the rules generally applicable to shareholders of PFICs discussed above with respect to distributions received by us from such a PFIC and dispositions by us of the stock of such a PFIC (even though the U.S. Holder may not have received the proceeds of such distribution or disposition). Assuming we receive the necessary information from the PFIC in which we own stock, certain U.S. Holders may make the QEF election discussed above with respect to the stock of the PFIC owned by us, with the consequences discussed above. However, no assurance can be given that we will be able to provide U.S. Holders with such information.

If we were a PFIC, a holder of ordinary shares that is a U.S. Holder must file United States Internal Revenue Service Form 8621 for each tax year in which the U.S. Holder owns the ordinary shares.

You should consult your own tax advisor regarding our potential status as a PFIC and the tax consequences that would arise if we were treated as a PFIC.

Backup Withholding Tax and Information Reporting Requirements

United States backup withholding tax and information reporting requirements generally apply to certain payments to certain non-corporate holders of stock. Information reporting generally will apply to payments of dividends on, and to proceeds from the sale or redemption of, ordinary shares made within the United States, or by a United States payor or United States middleman, to a holder of ordinary shares, other than an exempt recipient (including a corporation, a payee that is not a United States person that provides an appropriate certification and certain other persons). A payor will be required to withhold backup withholding tax from any payments of dividends on, or the proceeds from the sale or redemption of, ordinary shares within the United States, or by a United States payor or United States middleman, to a holder, other than an exempt recipient, if such holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with, or establish an exemption from, such backup withholding tax requirements. The backup withholding tax rate is 28.0% for years through 2010.

Any amounts withheld under the backup withholding rules will be allowed as a refund or credit against the beneficial owner's United States federal income tax liability, if any, provided that the required information is furnished to the IRS.

The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are currently subject to the information and periodic reporting requirements of the U.S. Securities Exchange Act of 1934, as amended, generally referred to as the Exchange Act, and file periodic reports and other information with the Securities and Exchange Commission through its electronic data gathering, analysis and retrieval (EDGAR) system. Our securities filings, including this annual report and the exhibits thereto, are available for inspection and copying at the public reference facilities of the Securities and Exchange Commission located at Room 1580, 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the Securities and Exchange Commission at 100 F Street, N.E., Washington, DC 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. The Commission also maintains a website at http://www.sec.gov from which certain filings may be accessed.

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

I. Subsidiary Information

Not applicable.

ITEM 11: Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss related to changes in market prices, including interest rates and foreign exchange rates, of financial instruments that may adversely impact our consolidated financial position, results of operations or cash flows.

Risk of Interest Rate Fluctuation

We do not have any long-term borrowings. Our investments consist primarily of cash and cash equivalents and interest bearing, investment-grade investments in marketable securities. These marketable securities currently consist of corporate debt securities, money market funds and auction-rate securities. See “ITEM 3: Key Information—Risk Factors—We have invested a portion of our cash in auction-rate securities, which subjects us to liquidity and investment risk. Due to recent uncertainties in the capital markets regarding auction-rate securities, we recorded impairment charges in the fourth quarter of 2007 and the first quarter of 2008, and, if the fair value of these investments were to decline further, we could be required to record further impairment charges related to these investments” and “ITEM 5: Operating and Financial Review and Prospects—Operating Results—Overview—Financial income (expenses), net” for further information regarding our investments in auction rate securities. The primary objective of our investment activities is to preserve principal while maximizing the income that we receive from our investments without significantly increasing risk and loss. Our investments are exposed to market risk due to fluctuation in interest rates, which may affect our interest income and the fair market value of our investments. We manage this exposure by performing ongoing evaluations of our investments. Due to the short and medium-term maturities of our investments to date, their carrying value approximates the fair value. We generally hold investments to maturity in order to limit our exposure to interest rate fluctuations.

Foreign Currency Exchange Risk

Our foreign currency exposures give rise to market risk associated with exchange rate movements of the U.S.dollar, our functional and reporting currency, mainly against the NIS. In 2007, we derived our revenues principally in U.S.dollars. Although a substantial part of our expenses were denominated in U.S.dollars, a significant portion of our expenses were denominated in shekels and to a lesser extent in euros and other Asian 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. If the U.S.dollar continues to weaken against the shekel or other currencies we are exposed to, there will be a negative impact on our profit margins.

Impact of Inflation

We believe that the rate of inflation in Israel has had a minor effect on our business to date. However, our U.S. dollar costs in Israel will increase if inflation in Israel exceeds the devaluation of the shekel against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel.

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

Year ended December 31,	Israeli inflation rate %	Israeli devaluation (appreciation) rate %	Israeli inflation adjusted for devaluation %
2005	2.4	6.7	(4.3)
2006	(0.1)	(8.2)	8.1
2007	3.4	(9.0)	12.4

We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the shekel against the dollar or if the timing of the devaluation lags behind inflation in Israel.

ITEM 12: Description of Securities Other Than Equity Securities

Not applicable.

PART II

ITEM 13: Defaults, Dividend Arrearages and Delinquencies

None.

ITEM 14: Material Modifications to the Rights of Security Holders and Use of Proceed

A. Material Modifications to the Rights of Security Holders

None.

E. Use of Proceeds

The effective date of the registration statement (file no. 333-138313) for our initial public offering of ordinary shares, par value NIS 0.10, was November 15, 2006. The offering commenced on November 15, 2006 and terminated after the sale of all the securities registered. Lehman Brothers Inc. acted as the sole book-running manager for the offering, Deutsche Bank Securities Inc. acted as co-lead manager and, CIBC World Markets Corp. and RBC Capital Markets Corporation acted as co-managers. We registered 6,500,000 ordinary shares in the offering. We sold 6,500,000 ordinary shares at an aggregate offering price of $78 million at a price per share of $12.00. Under the terms of the offering, we incurred aggregate underwriting discounts of $5.5 million. We also incurred expenses of $2 million in connection with the offering. The net proceeds that we received as a result of the offering were $70.5 million.

From the effective date of the registration statement and until December 31, 2007, the net proceeds had been invested in cash equivalents, marketable securities, capital expenditure and other corporate purposes.

None of the net proceeds of the offering was paid directly or indirectly to any director, officer, general partner of ours or to their associates, persons owning ten percent or more of any class of our equity securities, or to any of our affiliates.

ITEM 15: Controls and Procedures

(a) Disclosure Controls and Procedures. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2007. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2007, we have in place effective controls and procedures designed to ensure that information disclosed by us in the reports we file or submit under the Exchange Act and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

(b) Management’s Annual Report on Internal Control Over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

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

Our management recognizes that there are inherent limitations in the effectiveness of any system of internal control over financial reporting, including the possibility of human error and the circumvention or override of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation, and may not prevent or detect all misstatements. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. Our management has concluded, based on its assessment, that our internal control over financial reporting was effective as of December 31, 2007.

Our financial statements have been audited by Kost, Forer, Gabbay & Kasierer (a Member of Ernst & Young Global), an independent registered public accounting firm.

(c) Attestation Report of Registered Public Accounting Firm: See the report of Kost Forer Gabbay & Kasierer (a Member of Ernst & Young Global), an independent registered public accounting firm, included under “ITEM 18: Financial Statements” on page F-3.

(d) Changes in Internal Control Over Financial Reporting. During the period covered by this report, no material changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) have occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16: Reserved

ITEM 16A: Audit Committee Financial Expert

The board of directors has determined that Nurit Benjamini is the financial expert serving on its audit committee and that Ms. Benjamini is independent under the rules of The Nasdaq Stock Market.

ITEM 16B: Code of Ethics

We have adopted a code of ethics applicable to our Chief Executive Officer, Chief Financial Officer, controller and persons performing similar functions. This code has been posted on our website, www.allot.com.

ITEM 16C: Principal Accountant Fees and Services

Fees paid to the Auditors

The following table sets forth, for each of the years indicated, the fees billed by our independent registered public accounting firm.

	Year ended December, 31,	
	2006	2007
	(in thousands of U.S. dollars)	
Audit Fees(1)	$ 426	$ 265
Audit-Related Fees(2)	–	15
Tax Fees(3)	11	29
All Other Fees(4)	5	25
Total	$ 442	$ 334

(1) "Audit fees" include fees for services performed by our independent public accounting firm in connection with our annual audit for 2007 (including the audit required by Section 404 of the Sarbanes-Oxley Act), certain procedures regarding our quarterly financial results submitted on Form 6-K and consultation concerning financial accounting and reporting standards.
(2) "Audit-Related fees" include fees for the performance of due diligence investigations.
(3) "Tax fees" include fees for professional services rendered by our independent registered public accounting firm for tax compliance and tax advice on actual or contemplated transactions.
(4) "Other fees" include fees for services rendered by our independent registered public accounting firm with respect to government incentives.

Audit Committee's Pre-Approval Policies and Procedures

Our audit committee pre-approved all audit and non-audit services provided to us and to our subsidiaries during the periods listed above.

ITEM 16D: Exemptions from the Listing Standards for Audit Committees

Not applicable.

ITEM 16E: Purchase of Equity Securities by the Company and Affiliated Purchasers

Not applicable.

PART III

ITEM 17: Financial Statements

Not applicable.

ITEM 18: Financial Statements

See Financial Statements included at the end of this report.

ITEM 19: Exhibits

See exhibit index incorporated herein by reference.

SIGNATURES

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

Allot Communications Ltd.

By: /s/ Rami Hadar

Rami Hadar
Chief Executive Officer and President

Dated: June 27, 2008

ANNUAL REPORT ON FORM 20-F

INDEX OF EXHIBITS

Number	Description
1.1	Articles of Association of the Registrant (1)
1.2	Certificate of Name Change (1)
2.1	Specimen share certificate (1)
2.2	Second Amended and Restated Investors Rights Agreement, dated October 26, 2006, by and among the parties thereto and the Registrant (1)
3.1	Escrow Agreement, dated January 28, 1998 by and among Yigal Jacoby, Ravillan Benzur & Co., Law Offices and the Registrant; Escrow Letter of Resignation and Appointment, dated January 31, 2004 by and among Yigal Jacoby, Yolovelsky, Dinstein, Sneh & Co. and the Registrant; and Assignment of Escrow Agreement, dated May 21, 2006 by and among Yodan Trust Company Ltd., Oro Trust Company Ltd., Yigal Jacoby and the Registrant (1)
3.2	Addendum, dated October 26, 2006, to Escrow Agreement, dated January 28, 1998, by and between Yigal Jacoby and the Registrant (1)
4.1	Share Purchase Agreement, dated May 18, 2006, by and among the parties thereto and the Registrant (1)
4.2	Non-Competition Agreement, dated August 24, 2004, by and among Odem Rotem Holdings Ltd., Yigal Jacoby and the Registrant (1)
4.3	Experteam Training Services Proposal, dated as of March 2006, by Experteam to the Registrant (1)
4.4	Warrant to Purchase Series C-1 Shares, dated November 27, 2001, by and between the Company and Yigal Jacoby (1)
4.5	Manufacturing Agreement, dated September 4, 2002, by and between R.H. Electronics Ltd. and the Registrant* (1)
4.6	Non-Stabilized Lease Agreement, dated February 13, 2006, by and among, Aderet Hod Hasharon Ltd., Miritz, Inc., Leah and Israel Ruben Assets Ltd., Tamar and Moshe Cohen Assets Ltd., Drish Assets Ltd., S. L. A. A. Assets and Consulting Ltd., Iris Katz Ltd., Y. A. Groder Investments Ltd., Ginotel Hod Hasharon 2000 Ltd. and Allot Communications Ltd. (1)
4.7	Key Employees of Subsidiaries and Consultants Share Incentive Plan (1997) (1)
4.8	Key Employees Share Incentive Plan (1997) (1)

Number	Description
4.9	Key Employees Share Incentive Plan (2003) (1)
4.10	2006 Incentive Compensation Plan (1)
4.11	Manufacturing Agreement, dated July 19, 2007, by and between Flextronics (Israel) Ltd. and the Registrant*
4.12	Agreement relating to the sale and purchase of the Business and Assets dated January 1, 2008 by and between Esphion Limited and the Registrant
8.1	List of Subsidiaries of the Registrant
11.1	Code of Ethics (2)
12.1	Certification of Principal Executive Officer required by Rule 13a-14(a) and Rule 15d-14(a) (Section 302 Certifications)
12.2	Certification of Principal Financial Officer required by Rule 13a-14(a) and Rule 15d-14(a) (Section 302 Certifications)
13.1	Certification of Principal Executive Officer and Principal Financial Officer required by Rule 13a-14(b) and Rule 15d-14(b) (Section 906 Certifications) (3)
14.1	Consent of Kost Forer Gabbay & Kasierer

(1) Previously filed with the Securities and Exchange Commission on October 31, 2006 pursuant to a registration statement on Form F-1 (File No. 333-138313) and incorporated by reference herein.

(2) Previously filled with the Securities and Exchange Commission on June 28, 2007 on Form 20-F for the year ended December 31, 2006 and incorporated by reference herein.

(3) This document is being furnished in accordance with SEC Release Nos. 33-8212 and 34-47551.

* Portions of this exhibit were omitted and have been filed separately with the Secretary of the Securities and Exchange Commission pursuant to the Registrant's application requesting confidential treatment under Rule 24b-2 of the Exchange Act.

ALLOT COMMUNICATIONS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2007

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

ALLOT COMMUNICATIONS LTD. AND ITS SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of Allot Communications Ltd. ("the Company") and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As explained in Note 2 to the consolidated financial statements, on January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123(revised 2004), "Share Based Payment".

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 26, 2008 expressed an unqualified opinion thereon.

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

Tel-Aviv, Israel
June 26, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

ALLOT COMMUNICATIONS LTD. AND ITS SUBSIDIARIES

We have audited Allot Communications Ltd and its subsidiaries' (the "Company's") internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provide a reasonable basis for our opinion.

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

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

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In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2007 and our report dated June 26, 2008 expressed an unqualified opinion thereon.

/s/ KOST FORER GABBAY & KASIERER

Tel-Aviv, Israel
June 26, 2008

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2006	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,117	$ 28,101
Marketable securities	70,364	7,243
Short-term bank deposit	59	62
Trade receivables (net of allowance for doubtful accounts of $ 0 and $ 49 at December 31, 2006 and 2007, respectively)	4,178	6,122
Other receivables and prepaid expenses	1,961	3,799
Inventories	3,337	4,789
Total current assets	87,016	50,116
LONG-TERM ASSETS:		
Marketable securities	5,750	35,371
Severance pay fund	2,648	3,302
Deferred taxes	291	264
Other assets	763	744
Total long-term assets	9,452	39,681
PROPERTY AND EQUIPMENT, NET	2,939	4,619
GOODWILL AND INTANGIBLE ASSETS, NET	99	239
Total assets	$ 99,506	$ 94,655

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

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2006	2007
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit	$ 6	$ -
Trade payables	4,415	3,409
Employees and payroll accruals	2,610	3,590
Deferred revenues	2,580	3,968
Other payables and accrued expenses	2,223	1,924
Total current liabilities	11,834	12,891
LONG-TERM LIABILITIES:		
Deferred revenues	1,108	1,404
Accrued severance pay	2,377	3,175
Total long-term liabilities	3,485	4,579
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital -		
Ordinary shares of NIS 0.1 par value - Authorized: 200,000,000 shares at December 31, 2007 and 2006; Issued: 22,254,728 and 21,232,290 shares at December 31, 2007 and 2006, respectively; Outstanding: 22,008,249 and 20,985,811 shares at December 31, 2007 and 2006, respectively	456	480
Additional paid-in capital	121,069	123,913
Deferred stock compensation	(34)	-
Accumulated other comprehensive loss	(36)	-
Accumulated deficit	(37,268)	(47,208)
Total shareholders' equity	84,187	77,185
Total liabilities and shareholders' equity	$ 99,506	$ 94,655

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

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2005	2006	2007
Revenues:			
Products	$ 18,498	$ 28,756	$ 25,073
Services	4,474	5,388	7,429
Total revenues	22,972	34,144	32,502
Cost of revenues:			
Products	4,481	6,435	6,603
Services	938	1,162	1,416
Total cost of revenues	5,419	7,597	8,019
Gross profit	17,553	26,547	24,483
Operating expenses:			
Research and development, net	5,925	7,529	9,384
Sales and marketing	11,887	15,457	18,081
General and administrative	2,380	3,464	5,583
Total operating expenses	20,192	26,450	33,048
Operating income (loss)	(2,639)	97	(8,565)
Financial and other income (expenses), net	45	630	(845)
Income (loss) before income tax expenses (benefit)	(2,594)	727	(9,410)
Income tax expenses (benefit)	(218)	111	530
Net income (loss)	$ (2,376)	$ 616	$ (9,940)
Basic net earnings (loss) per share	$ (0.81)	$ 0.04	$ (0.46)
Diluted net earnings (loss) per share	$ (0.81)	$ 0.04	$ (0.46)
Weighted average number of shares used in computing basic net earnings (loss) per share	2,943,500	14,402,338	21,525,822
Weighted average number of shares used in computing diluted net earnings (loss) per share	2,943,500	16,423,227	21,525,822

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Ordinary shares		Convertible Preferred shares		Additional paid-in capital	Deferred stock compensation	Accumulated other comprehensive loss	Accumulated deficit	Total
	Shares	Amount	Shares	Amount					
Balance at January 1, 2005	2,447,568	$ 29	4,357,769	$ 103	$ 43,692	$ (119)	$ (4)	$ (35,508)	$ 8,193
Exercise of warrants and employee stock options	276,519	3	-	-	19	-	-	-	22
Compensation related to warrants and options granted to consultants	-	-	-	-	54	-	-	-	54
Deferred stock compensation	-	-	-	-	2	(2)	-	-	-
Amortization of stock-based compensation	-	-	-	-	205	46	-	-	251
Net unrealized loss on available-for-sale securities	-	-	-	-	-	-	(18)	-	(18)
Net loss	-	-	-	-	-	-	-	(2,376)	(2,376)
Balance at December 31, 2005	2,724,087	32	4,357,769	103	43,972	(75)	(22)	(37,884)	6,126
Issuance of share capital (net of expenses of $ 68)	-	-	452,157	10	5,422	-	-	-	5,432
Exercise of warrants and employee stock options	488,027	9	-	-	85	-	-	-	94
Compensation related to warrants and options granted to consultants	-	-	-	-	635	-	-	-	635
Amortization of stock-based compensation	-	-	-	-	685	41	-	-	726
Net unrealized loss on available-for-sale securities	-	-	-	-	-	-	(14)	-	(14)
Tax benefit related to exercise of stock options	-	-	-	-	99	-	-	-	99
Share dividend	342,588	8	6,131,170	139	(147)	-	-	-	-
Issuance of share capital upon Initial Public Offering, net of expenses of $ 7,527	6,500,000	150	-		70,323	-	-	-	70,473
Conversion of Convertible Preferred Shares	11,177,588	257	(10,941,096)	(252)	(5)	-	-	-	-
Net income	-	-	-	-	-	-	-	616	616
Balance at December 31, 2006	21,232,290	456	-	-	121,069	(34)	(36)	(37,268)	84,187
Exercise of warrants and employee stock options and repayment of non-recourse loan	1,022,438	24	-	-	1,448	-	-	-	1,472
Expenses related to issuance of share capital upon Initial Public Offering	-	-	-	-	(58)	-	-	-	(58)
Compensation related to options granted to consultants	-	-	-	-	(172)	-	-	-	(172)
Stock-based compensation related to options granted to employees	-	-	-	-	1,499	34	-	-	1,533
Realized loss on available-for-sale securities	-	-	-	-	-	-	36	-	36
Tax benefit related to exercise of stock options	-	-	-	-	127	-	-	-	127
Net loss	-	-	-	-	-	-	-	(9,940)	(9,940)
Balance at December 31, 2007	22,254,728	$ 480	-	$ -	$ 123,913	$ -	$ -	$ (47,208)	$ 77,185

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
Cash flows from operating activities:			
Net income (loss)	$ (2,376)	$ 616	$ (9,940)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation	559	893	1,486
Stock-based compensation related to options granted to employees and non-employees	305	1,361	1,361
Amortization of intangible assets	23	24	-
Capital loss	6	-	2
Decrease (increase) accrued severance pay, net	(3)	(75)	144
Decrease (increase) in other assets	19	(659)	19
Accrued interest on marketable securities	(4)	(223)	(82)
Decrease in other long-term liabilities	(294)	-	(228)
Increase in trade receivables	(194)	(648)	(1,944)
Increase in other receivables and prepaid expenses	(15)	(1,042)	(1,795)
Increase in inventories	(271)	(2,053)	(1,590)
Increase (decrease) in deferred taxes	(281)	(90)	102
Increase (decrease) in trade payables	536	2,122	(1,006)
Increase in employees and payroll accruals	219	938	980
Increase (decrease) in deferred revenues	1,315	(531)	1,684
Increase (decrease) in other payables and accrued expenses	562	560	(211)
Amortization of premium on marketable securities	-	46	38
Other than temporary loss on marketable securities	-	-	4,881
Amortization of discount on bank credit-line	50	-	-
Interest on short-term bank deposit	(1)	(1)	(3)
Net cash provided by (used in) operating activities	155	1,238	(6,102)
Cash flows from investing activities:			
Decrease in restricted cash	3	62	-
Purchase of property and equipment	(686)	(2,072)	(3,030)
Proceeds from sale of property and equipment	4	4	-
Investment in marketable securities	(4,300)	(104,118)	(87,134)
Proceeds from redemption or sale of marketable securities	4,550	32,525	115,751
Investment in severance pay fund	-	(271)	-
Net cash provided by (used in) investing activities	(429)	(73,870)	25,587

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
Cash flows from financing activities:			
Issuance of share capital upon initial public offering	-	70,473	-
Bank credit (repayment)	(166)	6	(6)
Exercise of warrants and employee stock options and repayment of non-recourse loan	22	94	1,436
Excess tax benefit from stock-based compensation	-	67	127
Expenses related to issuance of share capital upon Initial Public offering	-	-	(58)
Issuance of share capital, net	-	5,432	-
Net cash provided by (used in) financing activities	(144)	76,072	1,499
Increase (decrease) in cash and cash equivalents	(418)	3,440	20,984
Cash and cash equivalents at the beginning of the year	4,095	3,677	7,117
Cash and cash equivalents at the end of the year	$ 3,677	$ 7,117	$ 28,101

Supplementary cash flow information:

	2005	2006	2007
(a) Non-cash activities:			
Classification of inventory to property and equipment	$ 155	$ 281	$ 138
Exercise of options on account of other receivables	$ -	$ -	$ 36
Increase in goodwill on account of short term liability	$ -	$ -	$ 140
(b) Cash paid during the year for:			
Interest	$ 8	$ 3	$ 1
Taxes	$ -	$ 184	$ 69

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

NOTE 1: – GENERAL

Allot Communications Ltd. (the “Company”) was incorporated in November 1996 under the laws of the State of Israel. The Company is engaged in developing, selling and marketing broadband service optimization solutions using advanced deep packet inspection, or DPI, technology. The solutions provide broadband service providers and enterprises with real-time, highly granular visibility into network traffic, and enable them to efficiently and effectively manage and optimize their networks. The Company’s solutions are used to create policies to monitor network applications, enforce quality of service policies that guarantee mission-critical application performance, mitigate security risks and leverage network infrastructure investments. The Company’s products consist of the Service Gateway and NetEnforcer traffic management systems the NetXplorer and Subscribe Management Platform application management suites and following the acquisition of Esphion Limited, which was completed on January 8, 2008, also the Service Protector network protection solution. The products are also used by service providers to offer subscriber-based and application-based tiered services that enable them to optimize their service offerings. On November 16, 2006, trading in the Company’s ordinary shares commenced on the Nasdaq Stock Market.

The Company holds six wholly-owned subsidiaries (collectively “Allot”): Allot Communications, Inc. in Eden Prairie, Minnesota, United-States (the “US subsidiary”), which was incorporated in 1997 under the laws of the State of California, Allot Communication Europe SARL in Sophia, France (the “European subsidiary”), which was incorporated in 1998 under the laws of France, Allot Communications Japan K.K. in Tokyo, Japan (the “Japanese subsidiary”), which was incorporated in 2004 under the laws of Japan, Allot Communication (UK) Limited (the “UK subsidiary”), which was incorporated in 2006 under the laws of England and Wales, Allot Communications (Asia Pacific) Pte. Ltd. (the “Singaporean subsidiary”), which was incorporated in 2006 under the laws of Singapore, Allot Communications New Zealand Limited (the “NZ subsidiary”), which was incorporated in December 2007 under the laws of New Zealand.

The US subsidiary commenced operations in 1997. It engages in the sale, marketing and technical support services in America of products manufactured and imported by the Company. The European, Japanese, UK and Singaporean subsidiaries are engaged in marketing and technical support services of the Company’s products in Europe, Japan UK and Asia Pacific, respectively. The NZ subsidiary commenced its operations in 2008 and is engaged in the research and development of the ServiceProtector Solution, and technical support services such solutions.

During 2006 and 2005, approximately 20% and 16%, respectively, of Allot’s revenues derived from a single customer. During 2007, no revenues derived from this customer.

Allot currently depends on two subcontractors to manufacture and provide hardware warranty support for its traffic management system. If they experiences delays, disruptions, quality control problem or a loss in capacity, it could materially adversely affect Allot’s operating results (see also Note 7e). Certain components for the Service Gateway and NetEnforcer traffic management systems come from single or limited sources, and Allot could lose sales if these sources fail to satisfy its supply requirements.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (“U.S. GAAP”).

a. Use of estimates:

The preparation of financial statements, in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from such estimates.

b. Financial statements in U.S. dollars:

The majority of the revenues of the Company and certain of its subsidiaries are generated in U.S. dollars (“dollar”) or linked to the dollar. In addition, a majority portion of the Company’s and certain of its subsidiaries’ costs are incurred or determined in dollars. A portion of the Company and its subsidiaries’ costs is paid in local currencies. The Company’s management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52, “Foreign Currency Translation”. All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses as appropriate.

c. Principles of consolidation:

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

d. Cash and cash equivalents:

Allot considers all highly liquid investments which are readily convertible to cash with maturity of three months or less, at the date of acquisition, to be cash equivalents.

e. Marketable securities:

Allot accounts for its investments in marketable securities using Statement of Financial Accounting Standard No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (“SFAS No. 115”).

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company’s management determines the appropriate classification of marketable securities at the time of purchase and evaluates such designation as of each balance sheet date. To date, all debt securities have been classified as available-for-sale and are carried at fair market value. Fair value is determined based on observable market value quotes or, if market values are not available, using valuation models including assessments of counterparty credit worthiness, credit default risk, underlying security type of collaterals risk premium and overall capital market liquidity conditions. Declines in fair value that are considered other-than-temporary are charged to earnings and those that are considered temporary are reported, net of tax, as a component of accumulated other comprehensive income in stockholders’ equity. The cost of securities sold is based on the specific identification method.

As of December 31, 2007, the Company held marketable securities in U.S. dollars in the United States, which were classified as available for sale. The balance was composed of Auction Rate Securities (“ARS”) and corporate bonds. The ARS and corporate bonds bear interest at rates ranging from 4.59% to 7.55% per annum.

Following SEC Staff Accounting Bulletin No. 59, EITF 03-1 and FAS 115-1, management evaluated in each period whether declines in the market value of its securities are other than temporary. Where such declines are determined to be other than temporary, the related unrealized loss is recorded as a write-down included in financial expenses.

f. Short-term deposit:

A short-term bank deposit is a deposit with a maturity of more than three months but less than one year. The deposit is in dollars and bears interest at annual weighted average rate of 4.88% at December 31, 2007 and 2006. The short-term deposit is presented at cost, including accrued interest.

g. Inventories:

Inventories are stated at the lower of cost or market value. Cost of inventories is determined as the cost of raw materials, manufacturing cost and addition of allocable indirect costs. Cost is determined using the “First In First Out” (FIFO) method. Inventory write-offs due to technological obsolescence totaled $ 175, $ 289 and $ 179 in 2007, 2006 and 2005, respectively.

h. Property and equipment:

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

	%
Lab equipment	15-33
Computers and peripheral equipment	20-33
Office furniture	6-33
Leasehold improvements	By the shorter of term of the lease or the useful life of the asset

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Goodwill and intangible assets:

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

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

SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. The Company currently has one reporting unit. As of December 31, 2007, 2006 and 2005, no instances of impairment of goodwill were identified.

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. The Company amortizes its intangible assets on a straight line basis. As of December 31, 2007 and 2006, the intangible assets were fully amortized.

j. Impairment of long-lived assets:

Long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets 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, 2007, 2006 and 2005, no instances of impairment were identified.

k. Revenue recognition:

Allot generates revenues mainly from the sale of hardware and software products and such provision of maintenance and support services. Allot sells its products mostly through resellers, distributors, OEMs, system integrators and value added resellers, all of whom are considered end-customers from Allot’s perspective.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The software components of Allot's products are deemed to be more than incidental to the products as a whole, in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2") and EITF 03-5, "Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software." Therefore, Allot accounts for its product sales in accordance with SOP 97-2. Revenues from product sales are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable.

SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative objective fair value of the elements. Allot has adopted Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions" ("SOP 98-9"). According to SOP 98-9, revenues should be allocated to the different elements in the arrangement under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the residual method, at the outset of the arrangement with a customer, Allot defers revenue for the fair value of its undelivered elements (maintenance and support) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (hardware and software products) when all other criteria in SOP 97-2 have been met. Any discount in the arrangement is allocated to the delivered element. If sufficient VSOE does not exist for all undelivered elements, revenue is deferred for the entire arrangement until all revenue recognition criteria are met for such undelivered elements.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the applicable maintenance and support agreement. The VSOE of fair value of the maintenance and support services is determined based on the price charged when sold separately. Deferred revenues are classified as short and long terms and recognized as revenues at the time respective elements are provided.

Allot generally does not grant a right of return to its customers. However, when other customer incentives, such as returns or rebates, are expected and estimated, Allot records a provision at the time product revenues is recognized based on its experience in the last three years. The provision has been deducted from revenues and amounted to $ 467, $ 427 and $ 346 for the years ended December 31, 2007, 2006 and 2005, respectively.

Allot grants a one-year hardware warranty and three-month software warranty on all of its products. Allot estimates the costs that may be incurred under its warranty arrangements and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect Allot's warranty liability include the number of installed units, historical and anticipated rates of warranty claims and cost per claim. Allot periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Research and development costs:

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

Based on Allot's product development process, technological feasibility is established upon the completion of a working model. Allot does not incur material costs between the completion of a working model and the point at which the products are ready for general release. Therefore, research and development costs are charged to the statement of operations as incurred.

m. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to Israeli severance pay law, based on the most recent monthly salary of its employees multiplied by the number of years of employment as of the balance sheet date for such employees. The Company's liability is partly provided by monthly deposits with severance pay funds and insurance policies and the remainder by an accrual.

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

Severance expenses for the years ended December 31, 2007, 2006 and 2005, amounted to approximately $ 952, $ 819 and $ 426, respectively.

n. Accounting for stock-based compensation:

Prior to January 1, 2006, the Company accounted for its stock based compensation awards using the intrinsic value method, under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related Interpretations, as permitted by Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123").

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standard No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), using the prospective-transition method. SFAS No. 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's Consolidated Statement of Operations.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Under the prospective-transition method, compensation costs recognized in 2006 includes compensation costs for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Allot applies SFAS No. 123 and Emerging Issues Task Force No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services” (“EITF No. 96-18”), with respect to options and warrants issued to non-employees. SFAS No. 123 requires the use of option valuation models to measure the fair value of the options and warrants at the measurement date as defined in EITF No. 96-18.

Effective January 1, 2006, Allot adopted the fair value recognition provisions of SFAS No. 123(R). For grants where Allot had previously presented the required SFAS No. 123 pro forma disclosures using the minimum value method, Allot adopted the new standard using the prospective transition method. As such, for those awards only, Allot will continue to apply APB 25 in future periods.

SFAS No. 123(R) requires the cash flows resulting from the tax deductions in excess of the compensation costs recognized for those stock options to be classified as financing cash flows. The excess tax benefit classified as financing cash inflows would have been classified as an operating cash flow if the Company had not adopted SFAS No. 123(R) at the amount of $ 127 and $ 67 in 2007 and 2006, respectively.

The following table sets forth the total stock-based compensation expense resulting from stock options included in the Consolidated Statements of Operations, for the years ended December 31, 2007 and 2006:

	Year ended December 31,	
	2006	2007
Cost of revenues	$ 15	$ 48
Research and development expenses, net	157	230
Sales and marketing expenses	650	340
General and administrative expenses	539	743
Total stock-based compensation expense	$ 1,361	$ 1,361

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value of stock-based awards was estimated using the Binomial model starting January 1, 2006 with the following weighted-average assumptions for the year ended December 31, 2007 and 2006:

	Year ended December 31,	
	2006	2007
Suboptimal exercise multiple	2-3	2-3
Interest rate	4.4%-5.33%	3.18%-5.38%
Volatility	80%-85%	75%
Dividend yield	0%	0%
Weighted-average fair value at grant date	4.37	8.57

The computation of expected volatility is based on realized historical stock price volatility of certain peer companies that the Company considered to be comparable based on market capitalization and type of technology platform. The computation of the suboptimal exercise multiple and the forfeiture rates are based on the employees expected exercise prior and post vesting termination behavior. The interest rate for period within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant. The Company currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

o. Concentration of credit risks:

Financial instruments that potentially subject Allot to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities, short-term deposits and trade receivables.

The majority of cash and cash equivalents, marketable securities and short-term deposits of Allot are invested in dollar deposits in major U.S. and Israeli banks. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions.

Allot’s trade receivables are primarily derived from sales to stable organizations located mainly in the United States, Europe and Asia.

Allot has no off-balance-sheet concentration of credit risk, such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

p. Royalty bearing grants:

Participation grants from the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor in Israel (“OCS”) for research and development activity are recognized at the time Allot is entitled to such grants on the basis of the costs incurred and included as a deduction of research and development costs. Research and development grants recognized amounted to $ 2,371, $ 1,811 and $ 727 in 2007, 2006 and 2005, respectively.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Income taxes:

Allot accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes ("SFAS No. 109") This Statement 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. Allot provides 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.

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainties in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of FIN 48, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely–than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue. As of January 1, 2007 there was no difference between the provisions of SFAS 5 and FIN 48 therefore no adjustment was recorded to the accumulated deficit.

Prior to 2007 the Company determined its tax contingencies in accordance with Statement of Financial Accounting Standard No. 5, "Accounting for Contingencies" ("SFAS No. 5"). The Company recorded estimated tax liabilities to the extent the contingencies were probable and could be reasonably estimated.

r. Basic and diluted net earnings (loss) per share:

The Company applies the two class method as required by EITF No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128" ("EITF No. 03-6"). EITF No. 03-6 requires the earnings (loss) per share for each class of shares (Ordinary shares and Preferred shares) to be calculated assuming 100% of the Company's earnings are distributed as dividends to each class of shares based on their contractual rights.

In compliance with EITF 03-6, the series of Preferred shares are not participating securities in losses, and therefore are not included in the computation of net loss per share.

Basic and diluted net earnings (losses) per share are computed based on the weighted average number of shares of Ordinary shares outstanding during each year. Diluted net earnings (losses) per share are computed based on the weighted-average number of Ordinary shares outstanding during the period, plus dilutive potential shares of Ordinary shares considered outstanding during the period, in accordance with Statement of Financial Standard No. 128, "Earnings Per Share."

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

For the years ended December 31, 2007 and 2005, all outstanding options, warrants and Preferred shares (as applicable) have been excluded from the calculation of the diluted loss per share since their effect was anti-dilutive.

For the year ended December 31, 2006, the total number of shares related to outstanding options excluded from the calculation of diluted net earnings per share was 572,790, because their inclusion would have been anti-dilutive.

s. Fair value of financial instruments:

The following methods and assumptions were used by Allot in estimating the fair value disclosures for financial instruments:

The carrying value of cash and cash equivalents, short-term deposits, trade receivables, other accounts receivable and prepaid expenses, trade payables and other liabilities approximate their fair values due to the short-term maturities of such instruments.

For marketable securities not actively traded, fair values are estimated using values obtained from the Company’s cash asset managers. To estimate the value of these investments the cash asset managers employ various models that take into consideration such factors, among others, as the credit rating of the issuer, effective maturity of the security, yields on comparably rated publicly traded securities, availability of insurance and risk-free yield curves. The actual value at which such securities could actually be sold or settled with a willing buyer or seller may differ from such estimated fair values depending on a number of factors including, but not limited to, current and future economic conditions, the quantity sold or settled, the presence of an active market and the availability of a willing buyer or seller.

t. Reclassification

Certain comparative numbers were reclassified in order to conform to the classification in the current year. Accordingly, an amount of approximately $ 1,678 was reclassified from deferred revenues to trade receivables as of December 31, 2006.

u. Impact of recently issued accounting standards:

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, “Fair Value Measurements” (“SFAS No. 157”). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. The statements does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007.

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, “Effective Date of FASB Statement No. 157” (“FSP 157-2”). FSP 157-2 amends SFAS No. 157 to delay the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, FSP 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS No. 157.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS No. 159”). This statement provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The SFAS No. 159 objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007. The adoption of SFAS No. 159 will not have effect on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 141R, “Business Combinations”, (“SFAS No. 141R”). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS No. 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company executes will be recorded and disclosed following existing GAAP until January 1, 2009.

The Company expects that SFAS No. 141R will have an impact on its consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions it consummates after the effective date. The Company is still assessing the impact of this standard on its future consolidated financial statements.

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

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In December 2007, the SEC staff issued Staff Accounting Bulletin No. 110 ("SAB 110"), which, effective January 1, 2008, amends and replaces SAB 107, Share-Based Payment. SAB 110 expresses the views of the SEC staff regarding the use of a "simplified" method in developing an estimate of expected term of "plain vanilla" share options in accordance with SFAS No. 123(R). Under the "simplified" method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. The use of the "simplified" method, which was first described in SAB 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the "simplified" method for "plain vanilla" awards in certain situations. The SEC staff does not expect the "simplified" method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. The Company is currently assessing the potential impact that the adoption of SAB 110 could have on its financial statements.

NOTE 3: – MARKETABLE SECURITIES

The following is a summary of available-for-sale securities:

	December 31, 2006			December 31, 2007		
	Carrying value	Unrealized losses	Market value	Carrying value	Unrealized losses	Market value
Auction rate securities (*)	$ 69,370	$ -	$ 69,370	$ 35,371	$ -	$ 35,371
Corporate bonds	-	-	-	7,243	-	7,243
Government agencies	6,780	(36)	6,744	-	-	-
Total securities	$ 76,150	$ (36)	$ 76,114	$ 42,614	$ -	$ 42,614

	December 31, 2006		December 31, 2007	
	Carrying value	Market value	Carrying value	Market value
Marketable securities with contractual maturities of less than one year	$ 70,370	$ 70,364	$ 7,243	$ 7,243
Marketable securities with contractual maturities of more than one year	5,780	5,750	35,371	35,371
Total securities	$ 76,150	$ 76,114	$ 42,614	$ 42,614

(*) Auction Rate Securities ("ARS") held by the Company are private placement securities with long-term nominal maturities for which the interest rates are reset through a "dutch" auction each month. The monthly auctions historically have provided a liquid market for these securities. The Company's investments in ARS represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub-prime mortgages

NOTE 3: – MARKETABLE SECURITIES (Cont.)

ARS investments had AAA and AA credit ratings at the time of purchase, however, with the liquidity issues experienced in global credit and capital markets, the ARS held by the Company at December 31, 2007 have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders.

Based on fair value indication received and valuation models applied by the investment banks and an analysis of other than temporary impairment factors, the Company has recorded a $ 4,881 impairment charge to reflect a devaluation of certain ARS that was considered as other-than-temporary. The impairment charge was included in finance income (expenses), net in the Company's statement of operations.

Historically, given the liquidity created by the auctions, ARS were presented as current assets under marketable securities on the Company's balance sheet. As a result of the failed auctions, in recent periods the Company's ARS are illiquid until there is a successful auction for them. Since there is uncertainty about the Company's ability to liquidate these ARS in a short time, the entire amount of such remaining ARS has been reclassified from current to non-current assets on the Company's balance sheet.

NOTE 4: – INVENTORIES

	December 31,	
	2006	2007
Raw materials	$ 909	$ 676
Finished products	2,428	4,113
	$ 3,337	$ 4,789

NOTE 5: – PROPERTY AND EQUIPMENT, NET

	2006	2007
Cost:		
Lab equipment	$ 3,100	$ 5,879
Computers and peripheral equipment	2,586	2,909
Office furniture and equipment	384	430
Leasehold improvements	253	271
	6,323	9,489
Accumulated depreciation	3,384	4,870
Depreciated cost	$ 2,939	$ 4,619

Depreciation expenses for the years ended December 31, 2007, 2006 and 2005, were $ 1,486, $ 893 and $ 559, respectively.

NOTE 6: – INTANGIBLE ASSETS, NET

a. In September 2002, Allot acquired the tangible and intangible assets of NetReality Ltd. ("NetReality"), an Israeli manufacturer of traffic management solutions, following NetReality's receivership proceedings filed with an Israeli court. Allot also recruited NetReality's employees.

In consideration for the assets acquired and liability assumed, Allot granted NetReality's receiver a fully-vested warrant to purchase 48,267 of series B Preferred shares (with an exercise price of $ 0.02 per share) ("NetReality Warrant"), and undertook to pay royalties at the rate of the higher of (i) 7% from the sales of the NetReality products; or (ii) 1% of the total sales of Allot. The royalties were set to be paid over a period of five years from the date of the acquisition with a minimum of $ 1,000 and maximum of $ 2,500. In connection with the commitment to pay royalties to the OCS, see Note 7a.

The purchase price was valued at approximately $ 1,254, based on the fair value of the warrant granted, and the minimum commitment to pay royalties.

The acquisition was accounted for in accordance with Statement of Financial Accounting Standards No. 141, "Business Combination," using the purchase method of accounting. Accordingly, the purchase price has been allocated to the assets acquired and the liability assumed based on their fair value at the date of acquisition. The fair values of the identified intangible assets were established based on an independent valuation study performed by a third-party specialist. The excess of the purchase price over the fair value of the net assets acquired has been recorded as goodwill.

NetReality's receiver exercised the NetReality Warrant upon the closing of Allot's initial public offering into 109,793 Ordinary shares and paid total exercise price of $ 1.

b. Amortization expenses for the years ended December 31, 2006 and 2005, were, $ 24 and $ 23, respectively. As of December 31, 2007, the intangible assets were fully amortized.

NOTE 7: – COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalties:

1. The Company received research and development grants from the OCS.

The Company is participating in programs sponsored by the Israeli Government for the support of research and development activities. Currently, the Company is obligated to pay royalties to the OCS, amounting to 3.5% of the sales of products of the Company and other related revenues generated, up to 100% of the grants received, linked to the U.S. dollar and for grants received after January 1, 1999 also bearing interest at the rate of LIBOR. The obligation to pay these royalties is contingent on actual sales of products of the Company and in the absence of such sales no payment is required.

NOTE 7: – COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

In connection with the NetReality acquisition, the Company assumed a commitment to pay royalties to the OCS up to the amount of the contingent liabilities derived from the grants that had been received by NetReality prior to the acquisition. In April 2007, the OCS notified the Company of its decision, as per the Company's request, to separate the NetReality related approved plans from other approved plans. The OCS also approved the discontinuation of the NetReality related approved plans and as a result, the balance of outstanding contingent obligation to pay royalties in the amount of $ 4,722 was waived.

Through December 31, 2007, the Company has paid or accrued royalties to the OCS in the amount of $ 4,826, which was recorded to cost of revenues.

As of December 31, 2007, the Company had an outstanding contingent obligation to pay royalties to the OCS in the amount of approximately $ 5,899.

2. The Company undertook to pay royalties to the receiver of NetReality.

The financial statements include a liability at present value of the royalties amount that will be paid to the receiver in the amount of $ 140. See Note 6a.

b. Lease commitments:

In February 2006, the Company signed an agreement to rent new offices for a period of seven years, starting July 2006. The rental expenses are $ 39 per month and a management fee of costs plus 15% of the expenses incurred by the building management company as stipulated in the lease agreement.

The US subsidiary has an operating lease for office facilities in Eden Prairie, Minnesota. The lease expires on August 31, 2008. The lease provides for a base monthly rent, adjusted annually for cost of living increases.

The Company's subsidiaries maintain smaller offices in Boston (U.S.), Tokyo (Japan), Singapore, Sophia (France), Bedford (UK) and Madrid (Spain).

In addition, Allot signed motor vehicle operating lease agreements. The terms of the lease agreements range from 36 to 39 months.

Operating leases (offices and motor vehicles) expenses for the years ended December 31, 2007, 2006 and 2005, were $ 2,484, $ 1,403 and $ 1,116, respectively.

NOTE 7: – COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

As of December 31, 2007, the aggregate future minimum lease obligations (offices and motor vehicles) under non-cancelable operating leases agreements were as follows:

Year ended December 31,		
2008	$	1,502
2009		983
2010		581
2011		473
2012 and thereafter		668
	$	4,207

c. Law Suit:

On May 1, 2007, a securities class action complaint, Brickman Investment Inc. v. Allot Communications Ltd. et al., was filed in the United States District Court for the Southern District of New York. A number of substantially similar complaints were filed in the same court after the original action was filed. The Company and certain of our directors and officers are named as defendants. The securities class action complaints allege that the defendants violated Sections 11 and 15 of the Securities Act of 1933 by making false and misleading statements and omissions in our registration statement for its initial public offering in November 2006. The claims are purportedly brought on behalf of persons who purchased the Company's ordinary shares pursuant to and/or traceable to the initial public offering on or about November 15, 2006 through April 2, 2007. The plaintiffs seek unspecified compensatory damages against the defendants, as well as attorney's fees and costs. Motions for consolidation and for appointment of lead plaintiff were filed on July 2, 2007 and were decided on March 27, 2008, with an order granting consolidation and appointing co-lead plaintiffs. The Consolidated Amended Compliant was served on June 9, 2008. No provision has been provided since the Company believes that the claims have no merit.

d. Liens and charges:

The Company placed a floating charge in favor of Hapoalim Bank B.M., on all its property, its assets and insurance rights in their respect, in return for credit lines which Hapoalim Bank B.M. has granted the Company. On October 11, 2006, Hapoalim Bank B.M. removed the floating charge.

e. Other:

The Company is dependent upon two subcontractors for acquiring components and assembling its products. The subcontractors maintain net supplier's inventory in accordance with the Company's selling forecasts. In the event that the Company terminates its business connection with the subcontractors, it will have to compensate the subcontractors for certain inventory costs, as specified in the agreement with the subcontractors.

NOTE 8: – SHAREHOLDERS' EQUITY

a. On October 26, 2006, the Company's shareholders approved a 10-for-1 reverse share split by a way of consolidation of every 10 shares of each class of shares into one share of the same class and, accordingly, all shares (Ordinary and Preferred), options, warrants and earnings (losses) per share amounts were adjusted to reflect this reverse share split. Accordingly, all such amounts have been retroactively adjusted in these financial statements. Following such reverse share split, each share has a par value of NIS 0.1 instead of NIS 0.01.

Effective as of October 29, 2006, following the above shareholders' approval, the Company's Board of Directors approved, in accordance with the Company's Interim Articles of Association (as approved by the Company's shareholders on October 26, 2006) ("Pre-IPO Articles of Association"), the following: (i) all Ordinary shares, options to purchase Ordinary shares and earnings (losses) per share amounts were adjusted to reflect a share dividend of approximately 1.275 Ordinary share for each Ordinary share; and (ii) the conversion price of each series A Ordinary share and Preferred share was adjusted to reflect such share dividend. Accordingly, all such amounts have been retroactively adjusted in previous financial statements.

It was further resolved to increase the Company's registered share capital to NIS 20,000,000.

b. Composition of share capital:

	Authorized		Issued		Outstanding	
	December 31,		December 31,		December 31,	
	2006	2007	2006	2007	2006	2007
	Number of shares					
Shares of NIS 0.01 par value:						
Ordinary shares (1), (2)	200,000,000	200,000,000	21,232,290	22,254,728	20,985,811	22,008,249
	200,000,000	200,000,000	21,232,290	22,254,728	20,985,811	22,008,249

(1) The Ordinary shares conferred upon their holders the right to receive notice of, and participate and vote such shares in general meetings of shareholders of the Company, the right to receive dividends, if and when declared. Until immediately prior to the Company's initial public offering, the Ordinary shares had the right to receive the remaining assets of the Company upon liquidation or deemed liquidation (as was defined in the Pre-IPO Articles of Association of the Company), subject to the preference in the distribution thereof to the holders of Preferred shares (as described below).

(2) Immediately prior to the closing of the Company's initial public offering, all of the then outstanding Preferred shares were converted into Ordinary shares. Ordinary shares confer upon their holders the right to receive notice of, and participate and vote such shares in general meetings of shareholders of the Company, the right to receive dividends, if and when declared and the right to receive the remaining assets of the Company upon liquidation.

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

NOTE 8: – SHAREHOLDERS' EQUITY (Cont.)

(3) Shares held in trust:

246,479 Ordinary shares resulting from conversion of series A Preferred shares that were converted immediately prior to the losing of the Company's initial public offering, are held in trust for the benefit of the Chairman of the Company's Board of Directors pursuant to a right to purchase pending his payment of the full purchase price of approximately $ 600. For the purposes of calculating shareholders equity, the Company has not considered such shares to be outstanding because neither the Chairman nor the trustee has voting or economic rights with respect to such shares.

In October 2006, the Company's shareholders and the Board of Directors approved an addendum to the escrow agreement with the Chairman of the Board of Directors regarding these shares. According to the addendum, if the right is not exercised prior to the consummation of a "Liquidity Event" as defined in the escrow agreement, or November 15, 2008, the right and the underlying shares will be forfeited. It was further approved that the Chairman has the right to pay for any portion of the shares by "net payment". As a result of the modification of the right, the Company recorded a total expense of $ 150.

c. Stock option plans:

A summary of the Company's stock option activity, pertaining to its option plans for employees and consultants, and related information is as follows:

	Year ended December 31,					
	2005		2006		2007	
	Number of shares upon exercise	Weighted average exercise price	Number of shares upon exercise	Weighted average exercise price	Number of shares upon exercise	Weighted average exercise price
Outstanding at beginning of year	2,066,601	$ 1.17	2,467,177	$ 1.56	3,383,930	$ 2.33
Granted	951,704	$ 2.24	1,138,517	$ 3.79	989,249	$ 8.57
Forfeited	(274,609)	$ 1.88	(103,182)	$ 2.12	(169,381)	$ 5.37
Exercised	(276,519)	$ 0.99	(118,582)	$ 0.76	(982,304)	$ 1.22
Outstanding at end of year	2,467,177	$ 1.56	3,383,930	$ 2.33	3,221,494	$ 4.42
Exercisable at end of year	1,183,754	$ 1.10	1,877,544	$ 1.52	1,532,506	$ 4.42

The aggregate intrinsic value represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fiscal year 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. This amount changes based on the fair market value of the Company's stock. The total intrinsic value of options outstanding at December 31, 2007, was $ 4,928. The total intrinsic value of exercisable options at the end of the year was approximately $ 3,751. The total intrinsic value of options vested and expected to vest at December 31, 2007 was approximately $ 4,783.

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

NOTE 8: – SHAREHOLDERS' EQUITY (Cont.)

The total intrinsic value of options exercised during the year ended December 31, 2007 was approximately $ 3,568. The number of options vested during the year ended December 31, 2007 was 488,996. The weighted-average remaining contractual life of the outstanding options as of December 31, 2007 was 7.58 years. The weighted-average remaining contractual life of exercisable options as of December 31, 2007, was 6.84 years. As of December 31, 2007, $ 4,855 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of approximately 1.9 years.

The options outstanding as of December 31, 2007, have been classified by exercise price, as follows:

Exercise price	Shares upon exercise of options outstanding as of December 31, 2007	Weighted average remaining contractual life	Shares upon exercise of options exercisable as of December 31, 2007
		Years	
$11.34-9.25	550,950	8.46	22,745
$7.62-6.14	317,000	9.15	1,250
$5.93-5.70	110,198	8.67	10,221
$4.616-4.167	251,298	7.42	92,590
$3.517-3.514	629,668	8.09	275,146
$2.242-2.240	996,651	7.11	767,177
$1.363-1.231	356,083	5.13	353,731
$0.009	9,646	3.50	9,646
	3,221,494		1,532,506

The Company has three option plans under which outstanding options as of December 31, 2007, are as follows: (i) under the 1997 option plan the outstanding options are exercisable for 10,556 Ordinary shares, (ii) under the 2003 option plan, the outstanding options are exercisable for 2,279,915 Ordinary shares (iii) under the 2006 option plan, the outstanding options are exercisable for 931,024 Ordinary shares.

Under the terms of the above option plans, options may be granted to employees, officers, directors and various service providers of the Company and its subsidiaries. The options generally become exercisable monthly over a four-year period, commencing one year after date of the grant, subject to the continued employment of the employee. The options generally expire no later than ten years from the date of the grant. The exercise price of the options granted under the plans may not be less than the nominal value of the shares into which such options are exercised. Any options, which are forfeited or cancelled before expiration, become available for future grants.

NOTE 8: – SHAREHOLDERS' EQUITY (Cont.)

The fair value assigned to the Ordinary shares in order to calculate the compensation resulting from employee option grants prior to the IPO, was determined primarily by management. In determining fair value, management has considered a number of factors, including independent valuations and appraisals.

The fair value of options granted in 2005 was estimated at the date of grant using the Minimum Value Model option pricing model.

The weighted average exercise prices and fair values of options granted during the years ended December 31, 2007, 2006 and 2005, were as follows:

	Year ended December 31,					
	2005		2006		2007	
	Weighted average fair value	Weighted average exercise price	Weighted average fair value	Weighted average exercise price	Weighted average fair value	Weighted average exercise price
Lower than market price at date of grant	$ -	$ -	$ -	$ -	$ -	$ -
Equals market price at date of grant	$ 0.35	$ 2.24	$ 2.58	$ 3.79	$ 4.53	$ 8.57
Greater than market price at date of grant	$ -	$ -	$ -	$ -	$ -	$ -

d. The Company's outstanding rights, warrants and options to investors and others as of December 31, 2007, are as follows:

Issuance date	Number of shares to be issued	Class of shares	Exercise price per share	Exercisable through
January 1998 (1)	246,479	Ordinary shares	$ 2.434	The earlier between a Liquidity event and two years after an IPO
October 2005 (2)	11,374	Ordinary shares	$ 2.24	October 2009

(1) Granted to the Chairman of the Board of Directors who also served as Chief Executive Officer at the time of the grant. The underlined shares are issued and held in trust for the benefit of the Chairman, pending his payment of the full purchase price of approximately $ 600. The Company does not consider these shares to be outstanding since, while these shares are held in trust, neither the Chairman nor the trustee have voting or economic rights with respect to such shares

(2) 56,868 options were granted to contractors in connection with advisory provided to the Board of Directors out of which 11,374 are outstanding and exercisable. All the options granted have a contractual life of 10 years and the exercised price was determined based on the share price at the date of grant.

NOTE 9: – TAXES ON INCOME

a. Corporate tax rates.

Generally, Israeli companies are subject to "Corporate Tax" on their taxable income. On July 25, 2005, the Knesset (Israeli Parliament) approved the Law of the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decreased in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. However, the effective tax rate payable by a company which derives income from an approved enterprise may be considerably less, (see Note 9b).

b. Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959 (the "Law"):

The Company's productions facilities have been granted a status of an "Approved Enterprise" under the Law. According to the provisions of the Law, the Company has elected the alternative package of benefits – and has waived Government grants in return for tax benefits.

According to the provisions of the Law, the Company's income is tax-exempt for a period of two years commencing with the year it first earns taxable income, and subject to corporate taxes at the reduced rate of 10% to 25%, for an additional period of five to eight years depending upon the level of foreign ownership of the Company. The benefit period of tax benefit has not yet commenced, since the Company has not yet reported taxable income.

The period of tax benefits, detailed above, is limited to the earlier of 12 years from the commencement of production (in 2000), or 14 years from the approval date, (December 8, 1998), (the year's limitation does not apply to the exemption period).

The entitlement to the above benefits is contingent upon the fulfillment of the conditions stipulated in the Law, regulations published there under and the criteria set forth in the specific certificates of approval. In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2007, management believes that the Company is meeting the aforementioned conditions.

The tax-exempt income attributable to the "Approved Enterprises" can be distributed to shareholders, without subjecting the Company to taxes, only upon the complete liquidation of the Company. If this retained tax-exempt income is distributed in a manner other than a complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits track (currently, between 10% to 25%).

NOTE 9: – TAXES ON INCOME (Cont.)

On April 1, 2005, an amendment to the Investment Law came into effect (the “Amendment”) and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by setting criteria for the approval of a facility as a Beneficiary Enterprise (rather than the previous terminology of Approved Enterprise), such as provisions generally requiring that at least 25% of the Beneficiary Enterprise’s income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer required for Investment Center approval in order to qualify for tax benefits. The period of tax benefits for a new “Beneficiary Enterprise” commences in the “Year of Commencement”. This year is the later of: (1) the year in which taxable income is first generated by the company, or (2) the Year of Election.

If a company requested the “Alternative Package” of benefits for an Approved Enterprise under the Law prior to the 2005 amendment, it is precluded from filing a Year of Election notice for a “Beneficiary Enterprise” for three years after the year in which the Approved Enterprise was activated.

In addition, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Law as they were on the date of such approval. Therefore the Company’s existing Approved Enterprise will generally not be subject to the provisions of the Amendment.

The Company currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

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

c. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, provides several tax benefits for industrial companies. An industrial company is defined as a company resident in Israel, at least 90% of the income of which in a given tax year exclusive of income from specified government loans, capital gains, interest and dividends, is derived from an industrial enterprise owned by it. An industrial enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

Under some tax laws and regulations, an industrial enterprise may be eligible for special depreciation rates for machinery, equipment and buildings. These rates differ based on various factors, including the date the operations begin and the number of work shifts. An industrial company owning an approved enterprise may choose between these special depreciation rates and the depreciation rates available to the approved enterprise.

NOTE 9: – TAXES ON INCOME (Cont.)

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. No assurance can be given that the Israeli tax authorities will agree that the Company qualifies, or, if the Company qualifies, then the Company will continue to qualify as an industrial company or that the benefits described above will be available to the Company in the future.

d. Pre-tax income (loss) is comprised as follows:

	Year ended December 31,		
	2005	2006	2007
Domestic	$ (2,867)	$ (1,144)	$ (9,318)
Foreign	273	1,871	(92)
	$ (2,594)	$ 727	$ (9,410)

e. A reconciliation of the theoretical tax expenses, assuming all income is taxed at the statutory tax rate applicable to the income of the Company and the actual tax expenses is as follows:

	Year ended December 31,		
	2005	2006	2007
Income (loss) before taxes on income	$ (2,594)	$ 727	$ (9,410)
Theoretical tax expense (benefit) computed at the statutory tax rate (34%, 31% and 29% for the years 2005, 2006 and 2007, respectively)	$ (882)	$ 225	$ (2,729)
Deferred tax asset for which valuation allowance was provided	603	(208)	2,685
Tax benefit related to exercise of options	-	(67)	-
Taxes with respect to prior years	30	85	(1)
Impairment of withholding tax asset	-	-	250
Non-deductible expenses and other	104	99	181
Other	(73)	(23)	144
Actual tax expenses (benefit)	$ (218)	$ 111	$ 530

Taxes on income are comprised as follows:

	2005	2006	2007
Current taxes	$ (531)	$ 111	$ 179
Deferred taxes	283	(85)	102
Taxes and deferred taxes in respect of previous years	30	85	(1)
Impairment of withholding tax asset	-	-	250
	$ (218)	$ 111	$ 530

NOTE 9: – TAXES ON INCOME (Cont.)

f. Net operating losses carryforward:

The Company has accumulated losses for tax purposes as of December 31, 2007, in the amount of approximately $ 38,000, which may be carried forward and offset against taxable income in the future for an indefinite period. The Company expects that during the period in which these tax losses are utilized its income would be substantially tax exempt. Accordingly, there will be no tax benefit available from such losses and no deferred income taxes have been included in these financial statements.

The European subsidiary is subject to French income taxes and has a net operating loss carryforward amounting to approximately $ 1.6 million as of December 31, 2007.

g. Deferred income taxes:

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

	December 31,	
	2006	2007
Deferred tax assets:		
Operating loss carry forward	$ 7,357	$ 9,986
Reserves and allowances	366	320
Deferred tax asset before valuation allowance	7,723	10,306
Valuation allowance	(7,325)	(10,010)
Net deferred tax asset	$ 398	$ 296

h. The Company adopted the provisions of FIN 48 on January 1, 2007. Prior to 2007 the Company used the provisions of SFAS 5 to determine tax contingencies. As of January 1, 2007, there was no material difference between the provision under FIN 48 therefore there was no effect on the Company's shareholders equity upon the Company's adoption of FIN 48.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Gross unrecognized tax benefits as of January 1, 2007	$ 180
Increase in tax position for prior years	24
Increase in tax position for current years	46
Gross unrecognized tax benefits as of December 31, 2007	$ 250

The Company conducts business globally and, as a result, the Company or one or more of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as Israel, France, and the United States. With few exceptions, the Company is no longer subject to Israeli final tax assessment through the year 2003 and the European and U.S. subsidiaries have final tax assessment through 2005 and 2002, respectively.

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

NOTE 10: – NET EARNINGS (LOSSES) PER SHARE

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

a. Numerator:

	Year ended December 31,		
	2005	2006	2007
Net income (loss) as reported	$ (2,376)	$ 616	$ (9,940)

b. Denominator:

	Number of shares		
Weighted average number of ordinary shares	2,943,500	14,402,338	21,525,822
Denominator for basic net losses per share of Ordinary shares	2,943,500	14,402,338	21,525,822
Effect of dilutive securities:			
Employee stock options and warrants	(*)	2,020,889	(*)
Denominator for diluted net earnings (losses) per share of Ordinary shares	2,943,500	16,423,227	21,525,822

(*) Anti-dilutive.

NOTE 11: – GEOGRAPHIC INFORMATION

Allot operates in a single reportable segment (see Note 1). Revenues are based on the customer's location:

	Year ended December 31,		
	2005	2006	2007
United Kingdom	$ 5,781	$ 8,566	$ 1,915
Europe (excluding United Kingdom)	4,916	8,030	8,581
MEA (Middle East and Africa)	831	1,662	2,061
United States of America	6,563	7,628	6,435
Americas (excluding United States of America)	842	1,236	3,636
AO (Asia and Oceania)	4,039	7,022	9,874
	$ 22,972	$ 34,144	$ 32,502

NOTE 11: – GEOGRAPHIC INFORMATION (Cont.)

The following presents total long-lived assets as of December 31, 2006 and 2007:

	December 31,	
	2006	2007
Long-lived assets:		
Israel	$ 3,488	$ 5,310
United States of America	218	170
Other	95	122
	$ 3,801	$ 5,602

NOTE 12: – FINANCIAL AND OTHER INCOME (EXPENSES)

	Year ended December 31,		
	2005	2006	2007
Financial and other income:			
Interest income	$ 204	$ 845	$ 4,193
Financial and other expenses:			
Interest expenses and other	(77)	(155)	(79)
Amortization of discount on bank credit-line	(50)	-	-
Foreign currency transactions differences, net	(32)	(60)	(78)
Impairment related to Auction Rate Securities	-	-	(4,881)
	$ 45	$ 630	$ (845)

NOTE 13: – SUBSEQUENT EVENTS

On January 8, 2008, the Company completed an acquisition of the business of Esphion Limited, a developer of network protection solutions for carriers and internet service providers. The Company believes that the acquisition furthers its vision of offering value-added services on its new Service Gateway platform to help broadband providers build secure and intelligent networks by purchasing certain assets. Total consideration including direct transaction costs for the acquisition was approximately $ 3,931, plus potential earn-outs based on performance milestones amounting to a maximum of an additional $ 2,000 payable through December 2008.

The Company allocated the purchase price of the acquisition to the tangible and intangible assets acquired, based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The fair value assigned to assets acquired is based on valuations using management’s estimates and assumptions. The Company recorded approximately $ 2,851 of goodwill and approximately $ 970 of purchased intangibles related to this acquisition.

Exhibit 4.11

EXHIBIT B

CERTAIN PORTIONS OF THIS EXHIBIT HAVE BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO A REQUEST FOR CONFIDENTIAL TREATMENT. THE SYMBOL "*" HAS BEEN INSERTED IN PLACE OF THE PORTIONS SO OMITTED

Flextronics Manufacturing Services Agreement

This Manufacturing Services Agreement ("Agreement") is entered into this as of July 19, 2007 by and between Allot Communications Ltd., having its place of business at 22 Hanagar St., Hod Hasharon, Israel ("Customer") and Flextronics (Israel) Ltd., having its place of business at Migdal – Haemek, P.O.B 867, Israel ("Flextronics") (Customer and Flextronics shall be referred to hereinafter, each a "Party" and collectively the "Parties").

Customer has created a market for Customer's Products as defined in **Exhibit A** and is solely responsible for the sales and marketing of the Products. Flextronics has developed processes and practices for manufacturing products for many different electronic applications and at Customer's request desires to manufacture the Products in accordance with Customer's specifications all subject to the terms and conditions contained herein. Customer acknowledges that Flextronics's expertise is manufacturing and that Flextronics's responsibility related to the Customer's Products is limited to this extent, The Parties agree as follows:

1. WORK, LICENSE, DEFINITIONS

1.1. **Work**. Flextronics agrees to perform the Work as defined in Section 1.3 herein pursuant to purchase orders or changes thereto issued by Customer and accepted by Flextronics subject to and in accordance with the terms and conditions stipulated in this Agreement.

1.2. **License**. Flextronics is hereby granted by Customer a non-exclusive, non-transferable or assignable, revocable license limited for the term of this Agreement to use Customer's patents, trade secrets and other intellectual property (hereinafter "**Customer's IP**") for the sole and exclusive purpose of performing Flextronics's obligations under this Agreement. Customer retains full ownership in Customer's IP including to any development and/or enhancement based on thereto, even if devised, created or developed by Flextronics (hereinafter "**IP Enhancements**"), and Customer's IP shall not be affected or limited in any manner whatsoever due to Flextronics's right to use such Customer's IP or IP Enhancements for the purpose of performing this Agreement. For avoidance of doubt, the use by Customer of the IP Enhancement shall be free of charge royalty free and be not subject to any restriction whatsoever. Customer's IP and IP Enhancements shall remain Confidential Information as more fully described in Section 10.1. By providing Flextronics the right to use Customer's IP and IP Enhancements for the sole purpose of performing this Agreement, Customer does not grant any express or implied right to Flextronics to or under any patents, copyrights, trademarks, or trade secret included in or related to Customer's IP other than the limited right to use the same as set forth above.

Flextronics shall use Customer's IP and IP Enhancements only in a manner and form pre-approved by Customer or pursuant to this Agreement. Flextronics will not misuse or divulge in any manner Customer's IP and/or IP Enhancements, and will not, or knowingly allow any third parties to: (i) delete or modify any Customer's IP proprietary notices which appear on or in the Product(s) or its related documents including the Specifications; (ii) directly or indirectly modify, change, alter or otherwise tamper the Specifications and/or the Product(s) and/or modify, adapt, translate or make derivative works based on the Specifications and/or Product(s); (iii) sell, sublicense, rent, lease, disclose, distribute, publish, copy, transfer, use or otherwise make the Specifications and/or Product(s) available to any third party other than Customer, or allow third parties other than Customer to use the Specifications and/or Product(s); and (iv) copy the documentation related to the Products – all except as otherwise specifically provided for in this Agreement.

If at any time, Flextronics becomes aware of any breach of the provision of Section 1.2 above, it shall promptly notify Customer in writing. Upon being aware of such breach, Flextronics shall promptly take steps to cure such breach to ensure that its use of Customer's IP and/or IP Enhancements shall comply with this Agreement. In the event a cure is not effected within 30 days period, then the license granted herein will automatically terminate until the standards of use are restored and Flextronics receives written notice from Customer that it may resume said uses of Customer IP and/or IP Enhancements.

1.3. **Definitions**. Flextronics and Customer agree to the following definitions:

"Approved Vendor List" or **"AVL"**	Shall mean a list of manufacturers currently approved by Customer to provide the Materials specified in the bill of materials for the Product.
"Confidential Information"	Shall mean any know-how, trade secrets, technical information, drawings, models, business information (including information contained in any reports provided under this Agreement), inventions, discoveries, methods, procedures, formulae, protocols, techniques, data, all whether disclosed in oral, written, graphic, or electronic form and including the Specification, Customer's IP and IP Enhancements.
"Cost"	As it relates to Inventory and Special Inventory shall mean the cost represented on the bill of Materials.
"Customer"	Shall mean Allot Communications Ltd.
"Customer Controlled Materials"	Shall mean certain Materials provided by suppliers with whom Customer has a commercial contractual or non contractual relationship, and which are included in the AVL.

"Customer Controlled Materials Terms" Shall mean the terms and conditions that Customer has negotiated with its suppliers for the purchase of Customer Controlled Materials.

"Disputes" Shall have the meaning set forth in Section 11.11 below.

"Logistics Data" Shall mean material procurement policy such as: Lead Time, Long Lead time, Economic Order Inventory, Minimum Order Quantity (MOQ), Order Multiple, Cancellation window and Order Period all as defined in **Exhibit B** attached hereto or as mutually agreed in writing.

"Economic Order Inventory" Shall mean Materials purchased in quantities greater than the required amount for purchase orders, in order to achieve price targets for such Materials.

"Flextronics" Shall mean Flextronics (Israel) Ltd.

"Inventory" Shall mean any Materials that are used to manufacture the Products based on the Logistics Data pursuant to a purchase order from the Customer.

"Lead Time(s)" Shall mean in Section 2.3 the lead time recorded on Flextronics's MRP system at the time of procurement of Inventory and Special Inventory or at the time of the cancellation of the purchase order or termination of this Agreement.

"Long Lead Time Materials" Shall mean Materials with lead times exceeding the period covered by the accepted purchase orders for the Product according to the Logistics Data or this Agreement.

"Materials" Shall mean labor, components, materials and supplies that are used in the manufacturing, testing, packaging and distribution of electronic products.

"Minimum Order Quantity" Shall mean Materials purchased according to the Logistics Data in excess of requirements for purchase orders because of minimum lot sizes available from manufacturers.

"Purchase Order/s" or "purchase order/s" Purchase orders for Products issued by Customer in accordance with the terms hereof and accepted by Flextronics

"Product" Shall mean the Customer's products described in **Exhibit C**.

"Special Inventory" Shall mean any Long Lead Time Materials and/or Minimum Order Quantity and/or Economic Order Inventory.

"Specifications" Shall mean the written specifications for each Product to be produced and provided by Customer, which shall include bill of Materials (including AVL), designs, schematics, assembly drawings, process documentation, test specifications, current revision number and any additional information reasonably requested by Flextronics or otherwise required hereunder.

"Work" Shall mean the manufacturing and delivery of the Products to Customer in accordance with and subject to the terms of this Agreement including: labor, the procurement of Inventory and Special Inventory, allocation of the required manpower, implementation of planning and control of the manufacturing process, execution of the integrating processes, assembling, testing, and packing of the Products, all of the foregoing pursuant to detailed written Specifications for each such Product which are attached to this Agreement and the delivering of such Products in accordance with Customer's Purchase Orders issued in accordance with the terms hereof.

"Reports and Metrics" Shall mean Customer reports and metrics that are defined by Customer and attached to this Agreement or otherwise mutually

agreed by the parties in writing and will be provided by Flextronics on a periodical basis.

2. FORECASTS, ORDERS, MATERIALS PROCUREMENT

2.1. **Forecast.** Customer shall provide Flextronics, on a monthly basis, a rolling six (6) months non-binding forecast indicating Customer's Product requirements on a monthly basis.

2.2. **Purchase Orders**. Customer will issue written electronic or fax transmitted purchase orders once per calendar month which specify all Products to be delivered within a minimum four (4) month period commencing on the date of acceptance of the purchase order. Each purchase order shall reference this Agreement and the applicable written Specifications as described in Section 1.3. Flextronics shall accept or reject each purchase order according to its terms (including the delivery date) within five (5) working days of receipt of such order. If a purchase order has not been confirmed within such period it shall be deemed rejected.

Customer may use its standard purchase order form to release items, quantities, prices, schedules, change notices, specifications, or other notices, subject to and in accordance with the terms and conditions provided for hereunder. Notwithstanding the foregoing, the Parties agree that the terms and conditions contained in this Agreement shall be the sole and exclusive terms and conditions related to the Work performed under this Agreement, unless Flextronics has explicitly agreed otherwise in writing in each instance by an authorized signatory.

2.3. **Materials Procurement**. Customer's accepted purchase orders will constitute authorization for Flextronics to procure Inventory and Special Inventory in compliance with the Logistics Data in order to manufacture the Products covered by such purchase orders.

Logistics Data will be reviewed and approved by Customer once per quarter prior to recording on Flextronics's MRP system. Customer will either approve or ask to amend (if necessary) Logistics Data within ten (10) days from receipt of data from Flextronics based on changes in manufacturers' items commercial terms in the market (i.e., lead time, prices, etc.). If Customer has not requested amendment within said period the Logistics Data shall be deemed approved.

Flextronics may purchase, subject to Customer prior written approval, Long Lead-Time Materials sufficient to meet all deliveries under the purchase orders and Product forecast in effect at the time the order with the supplier is placed, and may reasonably purchase Minimum Order Quantity even if greater than the amount necessary to meet purchase orders and Product forecast. Flextronics shall purchase Economic Order Inventory only subject to the prior written approval of Customer.

Flextronics agrees to use reasonable commercial actions in order to reduce the cost of the Materials procured, and of the performance of the Work.

2.4 **Preferred Supplier**. Simultaneously with the execution of this Agreement Customer shall provide Flextronics and maintain an Approved Vendor List ("Vendors"). Flextronics shall purchase from Vendors on a current AVL the Materials required to manufacture the Product. Customer shall allow Flextronics to suggest alternative vendors to be included on AVL's for Materials. Any such alternative vendor will be included in the AVL only if Customer's prior written approval was provided to Flextronics regarding such vendor.

3. SHIPMENTS, SCHEDULE CHANGE, CANCELLATION, STORAGE

3.1. **Delivering and Shipments**. Flextronics undertakes that all shipments to Customer will be made on the required delivery dates set forth in the related accepted purchase order and such shipments will contain the correct quantities ordered by Customer in the applicable Purchase Order. Provided, however, that Flextronics may reschedule a shipment to the extent the delay results from circumstances which are beyond its reasonable commercial control or such delay has been required, and/or consented by Customer. All Products delivered pursuant to the terms of this Agreement shall be suitably packed for shipment in accordance with Customer's Specifications and marked for shipment to Customer's destination specified in the applicable purchase order. Shipment terms will be to Customer's facilities (including to any facility designated by Customer) in Israel, provided, however, that upon prior reasonable written notice, Customer, at its option, may collect shipments from Flextronics' facility. Risk of loss and title to Product(s) will pass to Customer upon delivery to the above destinations as applicable. Any special packing expenses not included in the original price quotation for the Products, will be paid by Customer provided that Flextronics notifies customer in writing and in advance of such expense.

3.2. **Quantity Increases and Shipment Schedule Changes**.

For any accepted purchase order, Customer may without incurring any additional costs (i) increase the quantity of Products or (ii) reschedule the quantity of Products and/or their shipment date, both as provided in the table below. With respect to any increase in the quantity of Products, (1) Flextronics will be obligated to fulfill such increase as provided in the table below and (2) to the extent that such increase exceeds the allowable quantity increase provided in the table below, Flextronics will use reasonable commercial efforts to fulfill such excess increase.

Maximum Allowable Variance From Accepted Purchase Order Quantities/Shipment Dates

# of days before Shipment Date on Purchase Order	Allowable Quantity Increases	Maximum Reschedule Quantity	Maximum Reschedule Period
0-14	*%	*%	0
15-30	*%	*%	30 days
31-60	*%	*%	30 days
61-90	*%	*%	30 days
91-120	*%	*%	60 days

Any purchase order quantities increased or rescheduled pursuant to this subsection (a) may not be subsequently increased or rescheduled. Allowable quantity increases are subject to Materials' availability. Flextronics will use reasonable commercial efforts to meet quantity increases.

Except as set forth herein above, all changes in quantity or shipment date require Flextronics's prior written approval which will not be unreasonably withheld. If Customer wishes to reschedule in a manner not consistent with this Agreement (including rescheduling beyond the limitations as per the table above, whether or not consented by Flextronics), then Customer will issue an advance payment in the amount equal to the consideration under this Agreement due for the Excess Inventory (as defined below). However, any amount paid to Flextronics as an advance payment against Excess Inventory as detailed above, will be deducted from payment due to Flextronics for any future purchase(s) made by Customer under this Agreement of Products that include the same Inventory and/or Special Inventory, such deduction to be made in the amounts already paid under the pre-payment for the same items.

In addition, if Flextronics notifies Customer that such Inventory and/or Special Inventory has remained in Flextronics's possession for more than ninety (90) days since the reschedule request, then Customer agrees to immediately purchase such Inventory and/or Special Inventory from Flextronics upon receipt of the notice and to pay Flextronics for such Inventory, and Special Inventory as follows: (a) *% of the Cost of all Inventory and Special Inventory in Flextronics's possession which is not returnable without charge (unless the charge was approved by Customer as set forth in section (b) below) to the vendor or usable for other customers whether in raw form or work in process as determined in Flextronics' sole discretion, and of all Inventory and Special Inventory on order and not cancelable without charge (unless the charge was approved by Customer), (b) any vendor cancellation charges actually incurred or payable with respect to Inventory and/or Special Inventory accepted for cancellation or return to the vendor provided such cancellation charges were approved in writing in advance by Customer.

If Flextronics agrees to accept a reschedule or increase in excess of the flexibility table in subsection (a) and if there are extra costs to meet such reschedule or increase, Flextronics will inform Customer of such extra costs and will obtain from Customer its written approval of paying said extra costs. Customer shall not be liable for any additional costs incurred by Flextronics as set above, if such costs were not approved by Customer as set herein.

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* Omitted pursuant to a confidential treatment request. The confidential portion has been filed separately with the SEC.

Prior to invoicing Customer for the amounts due pursuant to this Section, Flextronics will use its reasonable commercial efforts to return unused Inventory and Special Inventory and to cancel pending orders for such inventory, and to dispose of it either through integration in other products, or in any other reasonably commercial possible manner, in order to mitigate the amounts payable by Customer. Customer shall pay all amounts due under this Section within thirty (30) days from the end of the calendar month on which Flextronics issued an invoice. Flextronics will ship the Inventory and Special Inventory paid for by Customer under this section to Customer or as instructed by Customer in writing, but in any event in Israel, promptly upon said payment by Customer. Risk of loss and title to that Inventory and Special Inventory will pass to Customer upon delivery to one of the above destinations. In the event Customer does not pay within above payment terms, and without derogating from Flextronics's remedies under law, Flextronics will be entitled to dispose of such Inventory and Special Inventory in a commercially reasonable manner, including with respect to price and to credit Customer for any monies received from third parties in consideration of the sale of aforesaid Inventory and/or Special Inventory. If the consideration received shall be less than the amounts due to Flextronics, Flextronics shall submit an invoice for the balance amount due and Customer agrees to pay said amount within thirty (30) days from the end of the calendar month on which such invoice was issued.

"**Excess Inventory**" shall be defined as inventory and non canceled open purchase order issued by Flextronics for Materials that do not have demand for the following three (3) months due to a change in Purchase Orders or forecast, or obsolescence. "Quarter" shall be defined as calendar quarter. Excess Inventory shall be calculated at the end of each Quarter. Customer shall issue an advance payment against the future purchase of Products equal to the Cost of Excess Inventory at the end of each Quarter. Reconciliation shall be made with respect to the residual balance of prior advance payments and the new Excess Inventory value.

3.3. **Cancellation of Orders and Customer Responsibility for Inventory**. Customer may cancel any portion of the Product quantity of an accepted purchase order at any time, provided that it will thereupon pay Flextronics for Products, Inventory, and Special Inventory affected by the cancellation as follows: (i) *% of the current price for all finished Products in Flextronics's possession; (ii) *% of the Cost of all Inventory and Special Inventory in Flextronics's possession and not returnable without charge (unless the charge was approved by Customer) to the vendor or usable for other customers at Flextronics sole discretion, whether in raw form or work in process; (iii) *% of the Cost of all Inventory and Special Inventory on order and not cancelable without charge (unless the charge was approved by Customer) or usable for other customers at Flextronics sole discretion; (iv) any vendor cancellation charges incurred with respect to Inventory and Special Inventory accepted for cancellation or return by the vendor provided such cancellation charges were approved in writing in advance by Customer and (v) Expenses incurred by Flextronics related to labor costs and equipment specifically put in place to support Customer's purchase orders, where such expenses, were pre-approved in writing by Customer. Without derogating from the aforesaid, Flextronics will use reasonable commercial efforts to reduce the cost borne by Customer as a result of the purchase order's cancellation.

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3.4. **Customer Responsibility for Ordered Product; Storage of Ordered Product**.

In the event Customer does not arrange for the prompt pickup of Products ordered and inspected by it under this Agreement within 14 days after being informed by Flextronics that such Products are ready for pickup in accordance with Customer's purchase order, then Customer hereby authorizes Flextronics to transfer such Products to a warehouse operated by Flextronics or a third party as instructed by Customer. Upon completing a transfer of said Product(s) to a third party warehouse, Flextronics will notify Customer regarding said transfer. Such transfer shall be considered a delivery and sale to Customer for all purposes of this Agreement, and title and risk of loss for such Products shall thereupon transfer from Flextronics to Customer. In accordance with the terms of this Agreement, Flextronics shall be entitled to invoice Customer for (i) such sale (Products) and (ii) in the event Product(s) are stored at Flextronics facilities storage and handling charges equal to *, or any portion thereof, that the Products are stored for Customer. Such storage and handling fee shall cover the expense of *. During the time that the Products are stored at Flextronics facilities pursuant to this section hereof, Customer shall have the right, upon prior reasonable written notice, to inspect the Products for the purposes of this Agreement. Customer may, at any given time, transfer by itself the Product(s) to any other facility or upon Customer's request, Flextronics shall ship the Products to Customer under the terms of this Agreement at Customer's expense.

3.5. **Audit and Access**

(i) Flextronics shall provide Customer periodical reports in the format agreed by Parties, which shall be submitted each quarter. Customer may request other reports pertaining to the Work and Flextronics will provide such reports, to the extent commercially reasonable.

(ii) Customer shall have the right, at its expense, to conduct audits of the manufacturing services and related facilities, for the purpose of auditing Flextronics's compliance with the manufacturing provisions of this Agreements, as follows: The audits may include, only the equipment designated for the manufacturing process, the facility at Flextronics's premises, finished goods warehouse, the inventory designated for the Work and Product(s) and any technical records (manufacturing specifications, production files and quality documentation). All audits shall be performed within Flextronics' facility. No documents or data of any kind, or any copies, may be removed from Flextronics' facility. Customer will conduct the audits in a reasonable manner so as not to cause undue disruption to Flextronics' Work. Audits shall be conducted during business hours, and shall be coordinated with Flextronics at least 72 hours in advance. In the course of such audits and at Customer sole expense Flextronics shall provide, and shall inform its subcontractors to provide, such auditors any reasonable assistance that they may require in accordance with the aforesaid.

(iii) If, as a result of an audit, it is thought that Flextronics has undercharged or overcharged Customer, Customer shall notify Flextronics in writing of the amount of such undercharge or overcharge, and shall specify the relevant data and the reasoning for its determination, The Parties will conduct in good faith discussion in order to reach an agreement regarding said undercharged or overcharged amounts.

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4. ENGINEERING CHANGES

Customer may request, in writing, that Flextronics incorporate engineering changes into the Product. Such request will include a description of the proposed engineering changes sufficient to permit Flextronics to accurately evaluate its feasibility and cost. Flextronics shall respond to Customer's request in writing, within 3 working days of notification and shall state the costs and time of implementation and the impact on the delivery schedule and pricing of the Product. Flextronics will not proceed with the engineering changes until the Parties have agreed upon the changes to the Product's Specifications, delivery schedule and Product pricing and the Customer has issued a purchase order for the implementation costs to be borne by the Customer and the Cost of Inventory and Special Inventory on-hand and on-order that becomes obsolete in connection therewith (it being clarified that if Products, Inventory and Special Inventory are cancelled as affected by the ECO then such Products, Inventory and Special Inventory will be invoiced and paid as per Section 3.3).

5. TOOLING, NON-RECURRING EXPENSES, SOFTWARE

Flextronics shall provide tooling that is not Product-specific at its expense. Customer shall pay for or obtain and deliver to Flextronics any Product-specific tooling and other reasonably necessary non-recurring expenses, to be set forth in Flextronics's quotation, such specific product or tooling shall remain Customer's sole and exclusive property ("Customer Tooling"). All Customer Tooling that Customer provides to Flextronics is and shall remain the sole property of Customer. Customer grants Flextronics a non exclusive, non transferable, non assignable license to use Customer Tooling: (i) only for the purposes required to perform Flextronics' obligations under this Agreement; (ii) subject to the terms and conditions set forth in section 1.2 above; (iii) provided Flextronics will not by itself or knowingly allow any third parties to (1) access, delete, modify, alter, or change software incorporated in Customer Tooling, or make inoperable authorization keys or license control utilities, or decompile or perform reverse engineering of such software, or modify, adapt, translate or make derivative works based on such software or the documentation related thereto; (2) sell, sublicense, rent, lease or otherwise commercialize, disclose, distribute, publish, copy, transfer or otherwise make such software available to any party other than Customer, or allow third parties other than Customer to use such software; and (iv) provided Flextronics will not transfer the license granted under this section to any third party, all except as otherwise required for the purposes of this Agreement but subject to Customer's prior written approval. All software developed by Flextronics (excluding any software which is a work for hire product pursuant to this Agreement) to support the process tooling or otherwise shall be and remain the property of Flextronics.

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6. EXPRESS LIMITED WARRANTIES

Flextronics warrants that for a period of thirteen (13) months from the date of shipment the Products will (a) be manufactured in accordance with Customer's applicable Specifications and will be free from defects in workmanship, (b) consist of new materials (not used, recycled, except as may be approved in advance by Customer, (c) be delivered to Customer free and clear of any third party right. Materials are warranted to the same extent that the original manufacturer warrants the Materials and Flextronics passes such warranties through to Customer. This express limited warranty does not apply to (a) Materials consigned or supplied by Customer to Flextronics; (b) defects resulting from Customer's Specifications or the design of the Products; and (c) Product that has been abused, damaged, altered or misused by any person or entity after title passes to Customer. With respect to first articles, prototypes, pre-production units, test units or other similar Products, Flextronics makes no representations or warranties whatsoever. Notwithstanding anything else in this Agreement or otherwise, Flextronics assumes no liability for or obligation related to the performance, accuracy, Specifications, failure to meet Specifications or defects of or due to tooling, designs or instructions produced or supplied by Customer. Upon any failure of a Product to comply with the above warranty, Flextronics' sole obligation, and Customer's sole remedy, is for Flextronics, at its option, to promptly repair or replace such unit and return it to Customer freight prepaid. Customer shall return Products covered by the warranty freight prepaid after completing a failure report and obtaining a return material authorization number from Flextronics to be displayed on the shipping container. Customer shall bear all of the risk, and all costs and expenses, associated with Products that have been returned to Flextronics for which there is no defect found. Customer will provide its own warranties directly to any of its end users or other third parties. Customer will not pass through to end users or other third parties the warranties made by Flextronics under this Agreement. Furthermore, Customer will not make any representations to end users or other third parties on behalf of Flextronics, and Customer will expressly indicate that the end users and third parties must look solely to Customer in connection with any problems, warranty claim or other matters concerning the Product.

EXCEPT AS SPECIFICALLY SET FORTH HEREIN, FLEXTRONICS MAKES NO OTHER WARRANTIES OR CONDITIONS ON THE PRODUCTS, EXPRESS, IMPLIED, STATUTORY, OR IN ANY OTHER PROVISION OF THIS AGREEMENT OR COMMUNICATION WITH

CUSTOMER, AND FLEXTRONICS SPECIFICALLY DISCLAIMS ANY IMPLIED WARRANTY OR CONDITION OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

7. PAYMENT TERMS, ADDITIONAL COSTS AND PRICE CHANGES

7.1. **Price and Payment Terms**. The price for Products to be manufactured will be agreed by the parties and will be indicated on the purchase orders issued by Customer and accepted by Flextronics. The initial price shall be as set forth on the Price List attached hereto and incorporated herein as **Exhibit D**. The initial price for Products should be reviewed on a quarterly basis by the Parties. Any changes and timing of changes shall be agreed upon in writing by the Parties. All prices quoted are exclusive of VAT and customs taxes and same shall be born by Customer. Any other tax, cost or levy will be born by each Party according to applicable law. Payment for any Products, services or other costs to be paid by Customer, expect as specified in Sections 3.2 and 3.3 hereinabove shall be due thirty (30) days from the end of the calendar month on which invoice is issued. Customer agrees to pay one percent (1%) monthly interest on all late payments (Including all payments set forth in Sections 3.3 and 3.2).

7.2. **Standard Cost**. The Parties shall apply the following process for setting Standard Costs. "**Standard Cost**" shall be defined as the cost for components and materials based on supplier selling prices as mutually agreed between the Parties. Standard Costs shall be set for all Materials on a Quarterly basis. Standard Costs shall be fixed for each Quarter and shall be adjusted in each subsequent Quarter.

Flextronics shall propose updated Standard Costs to Customer in the first week of the last month of each Quarter which will be calculated as an average of actual open purchase orders with suppliers for the subsequent forty-five (45)-day period and be applied to the subsequent Quarter. Standard Costs for each Quarter shall be mutually agreed between the Parties during the second week of the last month in the Quarter. Product pricing for the next Quarter shall be based on the new Standard Costs and shall become effective on the first day of the Quarter.

In cases where the actual purchase price of any Material exceeds the Standard Cost by more than US$* during the Quarter, Flextronics shall contact Customer for written approval prior to the purchase of any such Material. Customer shall respond to such purchase price variance (PPV) requests within two (2) business days. Customer shall be deemed to have given its approval unless it delivers Flextronics a clear written advise to the contrary within said period. Flextronics is hereby granted a waiver from requesting written approval if the variant per order line is less than US$*.

7.3. **Purchase Price Variance Reconciliation and Inventory Revaluation**.

Adverse PPV is the responsibility of Customer on these standards.

There are two types of requests Flextronics can ask for regarding price change: Temporary price change / fixed price change.

Temporary price change could be asked for reasons like rescheduling delivery date, temporary allocation or other reasons, in such cases where Customer approved the change, the Standard Cost will remain the same for the next Quarter and Flextronics will debit Customer's account for the difference in price which will be paid within thirty (30) days from the end of the calendar month on which an invoice therefore was issued.

Fixed price change could be asked for reasons like allocation market price change or other reasons, in such cases where Customer approved the change, the Standard Cost will be changed in the next Quarter and Flextronics will debit Customer's account for the difference in price at the end of the Quarter. The amount will be calculated as the quantity of parts consumed in last Quarter that were purchased in increased price times the difference between the old price and the new price.

An example for temporary price change/fixed price change is attached hereto as **Exhibit E**.

7.4. **WIP & Finished Goods**.

At the end of each Quarter after the new Standard Cost of each part was determined, a new price for the Product will be calculated by Flextronics and presented to Customer. Those prices will take effect on the first day of the following Quarter.

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* Omitted pursuant to a confidential treatment request. The confidential portion has been filed separately with the SEC.

7.5. **Additional Costs**. Customer is responsible for (a) any and all expediting charges reasonably necessary because of a change in Customer's requirements which charges are preapproved, (b) any overtime charges based on manpower tariffs approved in advance by Customer, incurred as a result of delays in the normal production or interruption in the workflow process caused by Customer's change in the Specifications.

8. TERM AND TERMINATION

8.1. **Term**. The term of this Agreement shall commence on the date hereof and shall continue for one (1) year thereafter (hereinafter "**the initial term**") unless terminated as provided in Section 8.2 or 9 After the expiration of the initial term (unless this Agreement has been terminated earlier), this Agreement shall be automatically renewed for separate but successive one year terms.

8.2. **Termination**. This Agreement may be terminated by (a) Flextronics for any reason subject to one hundred and eighty (180) days prior written notice to the Customer; (b) Customer for any reason subject to ninety (90) days prior written notice to Flextronics; (c) by either Party if the other party defaults in the performance of any material terms or conditions of this Agreement (including any delivery or payment obligation) and such default continues unremedied for a period of thirty (30) days after the delivery of written notice thereof by the terminating Party to the other Party; (d) as specifically provided in this Agreement, or (e) by either Party upon the other Party seeking an order for relief under the bankruptcy laws of the State of Israel or similar laws of any other jurisdiction, a composition with or assignment for the benefit of creditors, or dissolution or liquidation proceedings are initiated by or against the other party and not withdrawn within 90 days or an attachment or similar encumbrance is levied over a substantial part of the other party's assets and is not removed within 90 days. Expiration or termination of this Agreement under any of the foregoing provisions shall not affect (i) the amounts due under this Agreement by either Party that exist on the

date of expiration or termination, and as of such date onwards the provisions of Sections 3.2, 3.3, and 3.4 shall apply with respect to payment and shipment to Customer of finished Products, Inventory, and Special Inventory in existence as of such date. For the sake of clarity: upon termination, Flextronics will cease all Work and Customer shall thereupon pay to Flextronics all amounts stated in Section 7.1 for all completed Products and as provided in Section 3.3 for any and all semi-finished products, Inventory, Special Inventory and Excess Inventory; (ii) any obligation due by Flextronics for the delivery and warranty of any Product(s) ordered prior to termination of this Agreement even if delivery date and/or warranty period related to said Product(s) is due after the Experation or Termination date. Notwithstanding termination or expiration of this Agreement, Sections 3, 6, 7.1, 8, 9 and 10 shall survive said termination or expiration, and (iii) Flextronics will return to Customer any property of Customer, including, but not limited to, demonstration equipment, Customer Tooling, Specifications, product and technical documentation, schematics, and all Confidential Information.

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9. LIABILITY, LIMITATION

9.1. **Patents, Copyrights, Trade Secrets, Other Proprietary Rights**. Customer shall defend and indemnify Flextronics from all claims, liabilities, costs, damages, judgments and reasonable attorney's fees (collectively, "**Losses**") resulting from or arising out of any infringement or other violation of any patents, patent rights, trademarks, trademark rights, trade names, trade name rights, copyrights, trade secrets, proprietary rights and processes or other such rights related to the Product or claims relating to Customer's instructions, tooling, specifications and designs ("**Claims**") provided that: (i) Flextronics will provide the Customer with prompt written notice of any Claim no later than 3 business days following receipt of notice by Flextronics; (ii) Flextronics will grant Customer sole control of the defense and settlement of Claims subject to any reasonable request of Flextronics and (iii) Flextronics will provide Customer with reasonable assistance, at Customer's sole expense. Customer assumes no liability for any Claims made by any third party to the extent that such Claims result from the use of specifications other than the Specification, unaltered by Flextronics or anyone on its behalf. Customer may at its sole option either: (1) procure for Flextronics the right to continue to perform this Agreement; (2) modify the Specification so that there will no longer be an infringement or misappropriation or (3) terminate this Agreement and pay Flextronics the consideration due under this Agreement for the Work performed until the date of termination, including all payments set forth in Section 3.3. Provided, with respect to Losses (excluding costs and reasonable attorney's fees) indemnity under this Section 9.1 will be available subject to judgment by a court, arbitrator or mediator or any other out of court settlement.

9.2. Flextronics shall defend and indemnify Customer from all Losses resulting from or arising out of any infringement or other violation of any patents, patent rights, trademarks, trademark rights, trade names, trade name rights, copyrights, trade secrets, proprietary rights and processes or other such rights as a result of the Work (including but not limited to manufacturing methods employed by Flextronics but excluding Claims as defined above) ("**Manufacturing Claims**") provided that: (i) Customer will provide Flextronics with prompt written notice of any Manufacturing Claim no later than 3 business days following receipt of notice by Customer; (ii) Customer will grant Flextronics sole control of the defense and settlement of Manufacturing Claims subject to any reasonable request of Customer and (iii) Customer will provide Flextronics with reasonable assistance, at Flextronics's sole expense. Flextronics may at its sole option either: (1) procure for Customer the right to continue to perform this Agreement; (2) modify its manufacturing methods so that there will no longer be an infringement or misappropriation or (3) terminate this Agreement and Section 8.2 shall apply. Provided, with respect to Losses (excluding costsand reasonable attorney's fees) indemnity under this Section 9.2 will be available subject to judgment by a court, arbitrator or mediator or any other out of court settlement.

9.3. **THE FOREGOING STATES THE ENTIRE LIABILITY OF THE PARTIES TO EACH OTHER CONCERNING INFRINGEMENT OF PATENT, COPYRIGHT, TRADE SECRET OR OTHER INTELLECTUAL PROPERTY RIGHTS.**

9.4. **No Other Liability**. **IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER FOR ANY INCIDENTAL, CONSEQUENTIAL, SPECIAL OR PUNITIVE DAMAGES OF ANY KIND OR NATURE ARISING OUT OF THIS AGREEMENT OR THE SALE OF PRODUCTS, WHETHER SUCH LIABILITY IS ASSERTED ON THE BASIS OF CONTRACT, TORT (INCLUDING THE POSSIBILITY OF NEGLIGENCE OR STRICT LIABILITY), OR OTHERWISE, EVEN IF THE PARTY HAS BEEN WARNED OF THE POSSIBILITY OF ANY SUCH LOSS OR DAMAGE, AND EVEN IF ANY OF THE LIMITED REMEDIES IN THIS AGREEMENT FAIL OF THEIR ESSENTIAL PURPOSE.**

CONFIDENTIALITY

9.5. **Non-Disclosure of Confidential Information**. Except to the extent expressly authorized by this Agreement or otherwise agreed in writing by the Parties, each Party agrees that, during the term of this Agreement and for five (5) years thereafter, it shall keep confidential and shall not publish or otherwise disclose and shall not use for any purpose other than as provided for in this Agreement, all Confidential Information furnished to it by the other Party pursuant to this Agreement unless the receiving party can demonstrate that such Confidential Information: (a) was already known to the receiving Party, other than under an obligation of confidentiality, at the time of disclosure by the other Party; (b) was generally available to the public or otherwise part of the public domain at the time of its disclosure to the receiving Party; (c) became generally available to the public or otherwise part of the public domain after its disclosure and other than through any act or omission of the receiving Party in breach of this Agreement; (d) was disclosed to the receiving Party by a third party without obligations of confidentiality with respect thereto; or (e) was independently discovered or developed by the receiving Party without the use of or access to Confidential Information belonging to the disclosing Party by persons who had no knowledge of or access to Confidential Information.

9.6. **Authorized Disclosures**. Each Party may disclose Confidential Information belonging to the other Party to the extent such disclosure is reasonably necessary in the following situations: (a) for the purpose of complying with applicable law, including without limitation the rules and regulations of the Securities and Exchange Commission or other relevant securities authority; (b) prosecuting or defending litigation; and (c) complying with applicable governmental regulations, provided, however, that the receiving Party gives the disclosing Party prompt notice thereof so that the disclosing Party may seek a protective order or other appropriate remedy, and further provided, that in the event that such protective order or other remedy is not obtained, the receiving Party shall furnish only that portion of the Confidential Information which is legally required, and shall exercise all efforts required to obtain confidential treatment for such information. Notwithstanding the foregoing, in the event a Party is required to make a disclosure of the other Party's Confidential Information pursuant to this sub-sections (a) or (b), it will, except where impracticable, give reasonable advance notice to the other Party of such disclosure.

9.7. **Employees; Agents**. The receiving Party undertakes to disclose the Confidential Information only to those of its employees who have to be so informed in order to ensure its proper evaluation, and provided, that such employees are bound by written confidentiality and non-use undertakings towards the receiving Party which also apply to the Confidential Information disclosed to the receiving Party under this Agreement. The receiving Party will be responsible for ensuring that the obligations of confidentiality and non-use contained herein are observed by all such employees, and it represents that it has instituted policies and

procedures which provide such adequate protection for the Confidential Information. The receiving Party shall bear full responsibility for any harm caused to the disclosing Party by disclosure to said employees.

10. MISCELLANEOUS

10.1. **Entire Agreement**. This Agreement constitutes the entire agreement between the Parties with respect to the transactions contemplated hereby and supersedes all prior agreements and understandings between the Parties relating to such transactions. In all respects, this Agreement shall govern and supersedes any other documents related to the Work contemplated herein including, without limitation, preprinted terms and conditions on Customer's purchase orders and these shall be of no force and effect.

10.2. **Amendments, Schedules and Appendices**. This Agreement may be amended only by written consent of both parties. Each Schedule and Appendix hereto is incorporated herein by this reference. The parties may amend any Schedule and Appendix from time to time by entering into a separate written agreement, referencing such Schedule and Appendix and specifying the amendment thereto, signed by an authorized representative of each of the parties.

10.3. **Independent Contractor**. Neither party shall, for any purpose, be deemed to be an agent of the other party and the relationship between the parties shall only be that of independent contractors. Neither party shall have any right or authority to assume or create any obligations or to make any representations or warranties on behalf of any other party, whether express or implied, or to bind the other party in any respect whatsoever.

10.4. **Insurance**. Flextronics and Customer agree to maintain appropriate insurance to cover their respective risks under this Agreement with coverage amounts commensurate with levels in their respective markets. Customer specifically agrees to maintain insurance coverage for any finished Products or Materials the title and risk of loss of which passes to Customer pursuant to this Agreement and which is stored on the premises of Flextronics.

10.5. **Force Majeure**. In the event that either party is prevented from performing or is unable to perform any of its obligations under this Agreement (other than a payment obligation) due to any Act of God, fire, casualty, flood, earthquake, war, strike, lockout, epidemic, destruction of production facilities, riot, insurrection, or any other cause unknown to the Parties at the execution of this Agreement which is beyond the reasonable control of the party invoking this section, and if such party shall have used its commercially reasonable efforts to mitigate its effects, inter alia as part of DRP (Disaster Recovery Plan) program, such Party shall give prompt written notice to the other Party regarding the circumstances surrounding such preventing event, its performance shall be excused, and the time for the performance shall be extended for the period of delay or inability to perform due to such occurrences. Regardless of the excuse of Force Majeure, if such Party is not able to perform within ninety (90) days after such event, the other Party may terminate the Agreement. Notwithstanding anything to the contrary herein or otherwise, neither party may rely on the aforesaid provisions or on any force majeure circumstance applicable by law as an excuse for non-payment.

10.6. **Successors, Assignment**. This Agreements shall be binding upon and inure to the benefit of the Parties hereto and their respective successors, assigns and legal representatives. Neither Party shall have the right to assign or otherwise transfer its rights or obligations under this Agreement except with the prior written consent of the other party, not to be unreasonably withheld. Notwithstanding the foregoing, Customer shall be entitled to transfer and/or assign this Agreement to any company controlling Customer (directly or indirectly), controlled by Customer or any affiliate of of Customer, subject to a 30 days prior written notification to Flextronics and provided that in such event Flextronics shall be entitled to assign this Agreement to Flextronics Inc.

10.7. **Notices**. All notices required or permitted under this Agreement will be in writing and will be deemed received (a) when delivered personally; (b) when sent by facsimile, evidenced by a written confirmation; (c) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid; or (d) two (2) days after deposit with a commercial overnight carrier. All communications will be sent to the addresses set forth above or to such other address as may be designated by a party by giving written notice to the other Party pursuant to this section.

10.8. **Set-off; Lien**. Amounts due hereunder may not be set off except with mutual prior written consent. It is specifically agreed that Flextronics shall not have any lien or any other similar right upon any Confidential Information, Costumer's IP and IP Enhancements and Flextronics hereby expressly waives any claim or demand to that effect.

10.9. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original instrument and all of which together shall constitute a single agreement.

10.10. **Disputes Resolution**

(i) Any dispute arising out of or relating to this Agreement or the breach, termination or validity thereof shall be exclusively settled in arbitration in accordance with substantial Israeli law. The arbitrator shall be agreed upon by the Parties and in the absence of an agreement within 21 days from the first written notice by a Party to the other Party of its determination to apply to arbitration, as shall be determined by the President of the Israeli Bar at the request of any party hereof.

(ii) Without derogating from rights of termination as detailed in this Agreement, it is clarified that Flextronics will continue to provide the Work and Customer shall continue to perform its obligations hereunder during any arbitration or legal proceedings commenced pursuant to this Section 11.10(i) above and the existence of a dispute shall not enable Flextronics to stop the Work or services or otherwise not timely perform its obligations or enable Customer to stop payments or otherwise not timely perform its obligations, except that Flextronics shall be entitled to demand appropriate securities, such as bank guarantees and pre-payments as a condition to the continued performance thereby of any further Work, unless otherwise determined by the Arbitrator.

(iii) The foregoing shall not affect the right of the parties to seek injunctions before the competent Court.

10.11. **Law and Jurisdiction**. This Agreement shall be governed by and construed in accordance with the laws of the state of Israel, without giving effect to choice of law rules. Section 11.10(i) shall not apply to disputes as to: (a) a breach of confidentiality obligations under this Agreement;

10.12. **Even-Handed Construction**. The terms and conditions as set forth in this Agreement have been arrived at after mutual negotiation, and it is the intention of the parties that its terms and conditions not be construed against any party merely because it was prepared by one of the parties.

10.13. **Controlling Language**. This Agreement is in English only, which language shall be controlling in all respects. All documents exchanged under this Agreement shall be in English.

AGREED TO:

Allot Communications Ltd.	Flextronics (Israel) Ltd.
By: /s/ Pini Gvili / /s/ Doron Faibish	By: /s/ Eli Kalif / /s/ Tzahi Rodrig
VP Operations / General Counsel	CFO / CEO

Agreement

relating to
the sale and purchase of the Business and Assets of Esphion Limited

Allot Communications Limited
Purchaser

and

Esphion Limited
Vendor

and

The persons listed in Part A of Schedule 1
Covenantors

and

The persons listed in Part B of Schedule 1
Key Shareholders

Date 1 January 2008

AUCKLAND VERO CENTRE, 48 SHORTLAND STREET
PO BOX 4199, AUCKLAND 1140, DX CP20509, NEW ZEALAND
TEL 64 9 916 8800 **FAX** 64 9 916 8801

BELL GULLY

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This **Agreement** is made on 1 January 2008

between (1) **Allot Communications Limited** a company incorporated in Israel (company number 51-239477-6) and having its principal executive offices at 22 Hanagar Street, Neve Ne'eman Industrial Zone B, Hod-Hasharon 45240, Israel (**Purchaser**)

and (2) **Esphion Limited** a company incorporated in New Zealand (company number 1101813) and having its registered office at Level 8, Westpac Trust Tower, 120 Albert Street, Auckland, New Zealand (**Vendor**)

and (3) **The persons listed in Part A of Schedule 1** (**Covenantors**)

and (4) **The persons listed in Part B of Schedule 1** (**Key Shareholders**)

Introduction

A. The Vendor owns the Assets and carries on the Business.

B. The Vendor has agreed to sell and the Purchaser has agreed to purchase the Assets and the Business on the terms set out in this Agreement.

C. The Key Shareholders have agreed to make certain representations and warranties to the Purchaser regarding the Assets and the Business.

It is agreed

1. Interpretation

1.1 Definitions

In this Agreement unless the context otherwise requires:

Adjusted Retention Amount means the amount determined in accordance with clause 5.6(b);

Agreed Form means in a form agreed to by the Vendor and Purchaser prior to execution of this Agreement and initialled on behalf of the Vendor and the Purchaser for the purposes of identification;

Agreement means this Agreement together with the schedules and appendices;

Agreement Date means the date of this Agreement;

Apportionment Statement means the statement prepared under clause 4.4*;*

Assets means all the assets of the Vendor, including the assets listed in Schedule 2, but excluding the Excluded Assets;

Assigned Covenants means the benefit of any restrictive covenants or restraints of trade given to or granted in favour of the Vendor by a third party concerning the Business and Assets;

Assigned Rights means all contractual and statutory rights owing by law (including the benefit of all warranties and covenants) that the Vendor has against any person relating to the Business or the supply by that person of the Assets to the Vendor (but excluding rights under insurance policies);

Balance Date means 30 September 2007;

Bill Rate means the average rate per annum (expressed as a percentage) as quoted on Reuters page BKBM (or any successor page displaying substantially the same information) under the heading "FRA (New Zealand inter-bank)" for bank accepted bills having a term of three months as fixed at 10.45am on the first Business Day following the due date (and on the first Business Day next following the expiration of each succeeding three-month period after the due date thereafter);

Business means the business of providing solutions and products for network protection operated by the Vendor from New Zealand;

Business Agreements means those agreements as listed in Appendix 8 and any Assigned Rights and Assigned Covenants;

Business Day means a day on which registered banks are open for general banking business other than a Saturday or Sunday in Auckland, New Zealand and registered banks are open for general banking business (other than the Saturday) in Tel Aviv, Israel;

Business Names means "Esphion", "NetDeflect" and "NetDetail";

Business Records means the records of and all information of the Vendor pertaining to the Business, including, without limitation:

(a) those dealing with all the transactions of the Business;

(b) those dealing with the production and supply of goods and services of the Business;

(c) lists of customers and suppliers of the Business;

(d) records of the Business Agreements;

(e) correspondence;

(f) personnel records;

(g) fixed assets registers;

(h) records relating to the Intellectual Property;

(i) stock registers; and

(j) information technology documentation and manuals,

together with all media containing such records, excluding the original books, accounts, financial statements, financial records, corporate statutory registers, taxation returns of the Vendor and other records of the Vendor which the Vendor is required by law to retain, but including true copies of them;

Companies Act means the Companies Act 1993;

Completion means the performance by the Vendor and Purchaser (or the Permitted Nominee) of their respective obligations under clause 7 or, as the context may require, the time at which such performance is completed;

Completion Date means 7 January 2008 or, as the case may require, the date on which Completion takes place;

Conditions means the conditions precedent to Completion set out in Schedule 4;

Confidential Information means the know-how, trade secrets, technical processes, information relating to products, services, finances, contractual arrangements with customers or suppliers and other information relating to the Business or Assets which by its nature, or by the circumstances of its disclosure to the holder of the information, is or could reasonably be expected to be regarded as confidential;

Consent means:

(a) any authorisation, approval, consent, licence, permit, franchise, permission, order, notification, filing, registration, lodgement, agreement, waiver, declaration or exemption from, by or with a Public Authority; and

(b) in relation to any thing which will be prohibited or restricted in whole or part by law if a Public Authority intervenes or acts in any way within a specified period after lodgement, filing, registration, or notification, the expiry of such period without such intervention or action;

Default Interest means interest calculated at the Bill Rate plus 4% per annum;

Disclosure Letter means the letter disclosing information against and qualifying the Warranties which is in Agreed Form;

Disclosure Material means the materials, responses or other information provided by the Vendor or its advisers to the Purchaser or its advisers or representatives, in writing or electronic form prior to signing of this Agreement, a complete list of which is set out in the Disclosure Letter;

Dispute has the meaning set out in clause 5.7(b);

Dispute Notice has the meaning set out in clause 5.7(a);

Dispute Process means the process set out in clause 5.7;

Earn Out Amount means the amount calculated under clause 5.2;

Earn Out Calculation Notice has the meaning set out in clause 5.3(b);

Earn Out Payment means the payment, if any, required under clause 4.1(b);

Earn Out Payment Date means the date being 30 days after the public announcement by the Purchaser of its annual financial results of operation for the year ending 31 December 2008 or 30 September 2009 (whichever is the earlier);

Earn Out Period means the period from the Completion Date until 31 December 2008;

Encumbrance means an interest or power reserved in or over an interest in any Asset created or otherwise arising under a debenture, mortgage, charge, pledge, lien, hypothecation, title retention, deed of trust, right of pre-emption or any other security interest (including a present or future right or interest in personal property that is a security interest for the purposes of the Personal Property Securities Act 1999) and includes any agreement to grant any of the foregoing in the future), but excludes:

(a) reservation of title by any of supplier in the ordinary course of business; and

(b) the encumbrances listed in Schedule 8;

Escrow Agent means Bell Gully Barristers and Solicitors;

Escrow Amount means US$1,500,000 and any additional amount as has the meaning set out in clause 17.4(c);

Escrow Deed means the deed in the form set out in Appendix 9;

Escrow Payment Date means the Completion Date;

Escrow Period means the period following the Escrow Payment Date and ending two years after the Completion Date;

Esphion Japan means Esphion Japan Kabushiki Kaisha, a Japanese incorporated company through which the joint venture established by the Vendor and LINC Media Inc. distributes the Vendor's Products in Japan;

Excluded Assets means:

(a) all the original books, accounts, financial statements, financial records, corporate statutory registers, taxation returns of the Vendor and other records of the Vendor which the Vendor is required by law to retain;

(b) cash in hand, at the bank, in transit or on deposit;

(c) the shares held by the Vendor in Esphion Japan;

(d) the shares held by the Vendor in Esphion Pty Limited;

(e) any other Asset listed in Schedule 2 that the Purchaser elects not to purchase prior to the Completion Date;

(f) any Tax receivable or ACC receivable whether or not due to the Vendor; and

(g) the benefit of any third party insurance policy of the Vendor;

Existing Employees means all of the employees of the Vendor in relation to the Business listed in Appendix 4 who have not given notice of resignation, or been given notice of termination expiring before Completion;

Event of Default means if a person suffers from all or any of the following:

(a) an order or judgement is made, a resolution is passed, any legal proceeding is issued that is not contested by the person or any voluntary corporate action is taken for the winding up, liquidation, bankruptcy, administration dissolution or reorganisation of the person except for the purpose of and followed by a solvent reconstruction;

(b) an encumbrancer takes possession of the whole or any material part of the property of the person or a receiver, receiver and manager, administrator receiver, inspector, trustee, statutory manager, administrator, liquidator or other similar person or official is appointed in respect of the person or the whole or any material part of its property and such appointment is not dismissed within 90 days;

(c) any distress, attachment, execution, judgment or other legal process is enforced or obtained on or against the whole or any material part of its property which is not dismissed within 90 days;

(d) the person:

  (i) ceases or suspends generally payment of a material part of its indebtedness (or announces an intention to do so) or is unable to pay its indebtedness as it falls due (or is deemed or presumed to be so under any relevant law);

  (ii) makes, or proposes to make, any assignment, arrangement or composition for the benefit of its creditors generally or a moratorium is agreed or declared in respect of or affecting all or any material part of its indebtedness;

(e) any event occurs which, under the law of any relevant jurisdiction, has an analogous or similar effect to any event mentioned in this clause.

Financial Statements means the audited financial statements according to NZ GAAP for the year ended 31 March 2007, which include a statement of financial performance, a statement of movements in equity for the year ended at this date and statement of financial position as of that date and notes to financials statements as of that date;

Fixed Assets means those items of plant, office equipment, machinery, software, computer equipment, fixtures, furniture, fittings, electrical and other installations and leasehold improvements (to the extent owned by the Vendor) which are used in the Business at the Completion Date, whether or not any of the foregoing appear in the Vendor's books and records, including the items set out in Appendix 1;

Goodwill means the goodwill, trading reputation of the Business and customers' relations;

Group Company means the Purchaser or any Related Company and the term "**Group**" shall mean the Purchaser and all its Related Companies including the Permitted Nominee;

GST means goods and services tax imposed under the GST Act;

GST Act means the Goods and Services Tax Act 1985;

Intangible Assets means all Assets excluding Tangible Assets;

Intangible Assets Purchase Price means the amount specified in clause 4.1(b);

Intellectual Property Rights means all Intellectual Property owned by the Vendor in any jurisdiction worldwide, including the Trade Marks and the Patents;

Intellectual Property Licence In means any licence granted to the Vendor in respect of any Intellectual Property currently used in the Business;

Intellectual Property means:

(a) software and related flow-charts, programmer notes, updates and data, whether in object or source code form;

(b) patents, whether in the form of utility patents or design patents and all pending applications for the patents; and

(c) trade marks, trade names, service marks, designs, logos and domain names, whether or not registered, and all pending applications for registration

of the same;

(d) copyrights, whether or not registered and all pending applications for registration of the same;

(e) inventions, know-how, information, trade secrets, confidential information, proprietary information, product designs, engineering specifications and drawings, technical information, processes, works of authorship, formulae, works-in-progress, research and development of information, databases, algorithms, business information such as customer lists, supplier lists and market analyses and other sensitive, discreet business information, all of the above whether patentable or non-patentable and whether or not registered or reduced to practice; and

(f) all other intellectual property rights not mentioned above;

IP Assignment and Confidentiality Agreements has the meaning set out in clause 6.7(c) of Schedule 3;

Key Shareholders means each of No 8 Ventures Management Limited (the sole shareholder of No 8 Ventures Nominees Limited and manager of the No. 2/VIF Seed Fund) and LINC Media Inc.

Key Shareholders' IP Warranties means any of the Warranties contained in clause 6 of Schedule 3;

Key Shareholders' Warranties means any of the Warranties contained in clauses 1, 2 and 6 of Schedule 3;

Leased Equipment means the items held by the Vendor for use in the Business on lease, hire or hire purchase, or conditional sale agreement, including those items of equipment listed in Appendix 2;

Leasehold Property means all the right, title and interest of the Vendor in the property leased at 8C Vega Place, Mairangi Bay, Auckland (being 152 square metres of the ground floor);

Leave Benefits means accrued entitlement to leave (including, without limitation, annual leave and long service leave but excluding sick leave) of the Employees who accept the Purchaser's or the Permitted Nominee's offer of employment pursuant to clause 11.1(b), in each case attributable to their service before the Completion Date;

Management Accounts means unaudited balance sheet and statements of operations for the following periods:

(a) the calendar quarter ended 31 March 2006;

(b) the calendar quarter ended 31 March 2007;

(c) the calendar quarter ended 30 June 2007;

(d) the calendar quarter ended 30 September 2007;

(e) the calendar quarter ended 30 December 2007; and

(f) for the period commencing on 1 October 2007 and ending on the Completion Date;

Material Adverse Event means any event or circumstance which has or is likely to have a material adverse effect on the financial condition, operations or commercial or financial prospects of the Business and the Assets or the Vendor which will or is likely to result in a loss, cost, expense or liability to the Business of USD50,000 or more;

Net Revenues means the total amount actually received from a customer under a firm purchaser order, net of:

(a) returns, and

(b) credits and refunds, including:

(i) price protection refunds;

(ii) discounts;

(iii) duties and Taxes (other than based on the Purchaser's net income) which are non refundable or which the Purchaser offset against any other tax liability;

(iv) shipping and transportation;

(v) third party charges or commission of any kind; and

(vi) any penalties borne directly by the Purchaser for the sale of products,

provided, however, that such amount is recognised for the purposes of the audited consolidated financial statements of the Purchaser in accordance with US GAAP;

NZD means the lawful currency of New Zealand;

NZ GAAP means generally accepted accounting practice in New Zealand as defined in section 3 of the Financial Reporting Act 1993;

Open Source Component has the meaning set out in clause 6.10 of Schedule 3;

Patents means the patents listed in Part B of Schedule 6;

Permitted Nominee has the meaning set out in clause 2.2(a);

Prepayments means all amounts paid by the Vendor prior to Completion to creditors of the Business in respect of goods or services to be supplied or provided to the Vendor in respect of the Business after Completion in the ordinary course of conducting the Business;

Product Warranties means any actual claims in respect of warranties, guarantees or other assurances given by the Vendor, its Subsidiaries or Esphion Japan:

(a) in relation to the Business (including the Vendor's Products); or

(b) which would ordinarily be liable for as a matter of law in relation to the Vendor's Products which were sold by the Business before Completion;

Public Authority means:

(a) any government in any jurisdiction whether national, federal, state, regional, territorial or local; and

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(b) any minister, department, office, commission, delegate, instrumentality, agency, board, authority or organisation of any government or any state-owned enterprise;

Purchase Price means the purchase price for the Business and the Assets calculated under clause 4.1 and as may be subsequently adjusted under this Agreement;

Purchaser's Products means any software and/or hardware generally made available for sale to the Purchaser's customers (other than the Vendor's Products or products copied from the Vendor's Products or portion thereof);

Purchaser's Offer has the meaning set out in clause 11.1(b);

Purchaser's Solicitors means Bell Gully;

Qualified Net Revenues means Net Revenue from the sale of Vendor's Products by the Purchaser or a Related Company as a stand alone solution or in combination with the Purchaser's Products;

Recipient has the meaning set out in clause 14.2;

Registered Intellectual Property has the meaning set out in clause 6.4 of Schedule 3;

Related Company has the meaning given to that term in section 2(3) of the Companies Act (read as if the expression "company", "holding company", and "subsidiary" in that section included any body corporate or equivalent entity wherever incorporated or established);

Reseller Agreement means a reseller agreement between the Purchaser and Esphion Japan granting to Esphion Japan non-exclusive reselling rights of certain of the Purchaser's Products in Japan;

Retention Amount means 25% of the Earn Out Amount;

Retention Payment Date means 1 October 2009;

Retention Period means the period commencing on the Earn Out Payment Date and ending on the Retention Payment Date;

Stock means the hardware purchased for intended delivery to the customers of the Business;

Supplier has the meaning set out in clause 14.2;

Tangible Assets means:

(a) the Fixed Assets;

(b) the Leased Equipment;

(c) the Stock;

(d) the Trade Debtors;

(e) the Business Agreements; and

(f) the Business Records;

Taxation or **Tax** means all forms of taxation (including income tax, goods and services tax, value added tax, capital gains tax, capital tax, transfer tax, withholding tax and provisional tax) and all other statutory, governmental or local governmental impositions, charges, duties (including stamp, estate and gift duties), levies, tariffs and rates, whether imposed or payable in New Zealand, the United States of America, Israel or elsewhere, and includes any related reassessment, penalties, fines, interest, costs and expenses;

Tax Invoice has the meaning given in the GST Act;

Taxable Supply has the meaning given in the GST Act;

Third Party Claim has the meaning set out in clause 15.6;

Total Consideration means the total of the Purchase Price (which for the avoidance of doubt includes the Earn Out Amount) as adjusted pursuant to this Agreement (including by way of any payment received by the Purchaser under the Warranties);

Trade Debtors means all trade debts (other than any Excluded Asset) owed to the Vendor at the Completion Date listed in the schedule delivered by the Vendor to the Purchaser at Completion;

Trade Marks means the trade marks listed in Part A of Schedule 6;

Undertaking Parties has the meaning set out in clause 12.1;

US GAAP means United States of America generally accepted accounting principles and practices as in effect from time to time and applied consistently throughout the periods involved;

USD means the lawful currency of the United States of America;

Vendor's Products means any software or other product that is currently being or at any time has been or will be:

(a) conceived; and

(b) written, developed, manufactured, marketed, distributed, licensed, sold or made available (as part of a service bureau, time-sharing, application service provider or similar arrangement or otherwise),

by any employee or contractor for the Vendor or after Completion, is copied or developed from any such software or other product or portion thereof;

Vendor's Software has the meaning set out in clause 6.2 of Schedule 3;

Vendor's Solicitors means Buddle Findlay;

Warranties means the warranties and representations given by the Vendor to the Purchaser pursuant to clause 15, as set out in Schedule 3;

Warranty Claim means any claim by the Purchaser against the Vendor under the Warranties; and

Websites means the websites listed in part C of Schedule 6.

1.2 **Construction of certain references**

In this Agreement, unless the context otherwise requires:

(a) **agreement** includes a contract, deed, licence, franchise, undertaking, arrangement or understanding (in each case whether oral or written) or other document recording obligations (whether mutual or otherwise);

(b) **disposal** of an asset includes a sale, gift, transfer or any other disposition of, or the grant of an option over, a right or interest, whether legal or equitable, in that asset or an agreement for any of those acts (and references to dispose are to be construed accordingly);

(c) **event** includes any act, omission, transaction or other occurrence (whether or not the Vendor is a party to it). References to the result of any event on or before the Completion Date include the combined result of two or more events, the first of which has taken place on or before that date.

1.3 **General references**

In this Agreement, unless the context otherwise requires:

(a) **Clause, schedule or appendix**

a reference to a clause, schedule or appendix is a reference to a clause of, schedule to or appendix to, this Agreement;

(b) **Varied document**

a reference to this Agreement or another instrument includes any variation or replacement of either of them;

(c) **Statutes**

a reference to a statute or other law includes regulations and other instruments under it and consolidations, amendments, re-enactments or replacements of any of them (whether before or after the Agreement Date);

(d) **Financial references**

references to and expressions used concerning financial calculations, valuations, accounting or financial reporting functions or their description in this Agreement bear the respective meanings ascribed to like expressions or expressions to similar intent under NZ GAAP unless reference is specifically made to US GAAP;

(e) **Singular includes plural**

the singular includes the plural and vice versa;

(f) **Person includes groups**

the word person includes an individual, a body corporate (whether incorporated or formed within or outside New Zealand), an association of persons (whether corporate or not), a trust, a state and an agency of state, in each case, whether or not having a separate legal personality;

(g) **Person includes successors**

a reference to a person includes a reference to the person's executors, administrators, successors, substitutes (including, but not limited to, persons taking by novation) and permitted assigns;

(h) **Joint and several**

an obligation or liability assumed by two or more persons shall be assumed by them severally unless otherwise stated;

(i) **Gender**

words importing one gender include the other genders;

(j) **Knowledge**

in this Agreement, the Disclosure Information and the Disclosure Letter, references to knowledge, awareness or belief of the Vendor (however expressed) are references to the actual knowledge only of Mark Edwards after making reasonable enquiry (whether or not that enquiry is actually made) and there shall be deemed to be included the knowledge of matters that he ought to be aware of by reason of his position and area of expertise, into the relevant matter. The parties acknowledge that reference to the knowledge, awareness and belief of the person named in this clause does not give rise to any personal liability of such person whatsoever to any party to this Agreement; and

(k) **Equivalent Terms**

a reference to any New Zealand legal term for any action, remedy, method of judicial proceeding, legal document, legal status, court, official, or any legal concept or thing shall in respect of any jurisdiction other than New Zealand be deemed to include what most nearly approximates in that jurisdiction to the New Zealand legal term and to any New Zealand statute shall be construed as to include equivalent or analogous laws of any other jurisdiction.

1.4 **Headings**

Ignore headings in construing this Agreement.

1.5 **Dispute as to GAAP**

Any dispute as to the meaning of NZ GAAP or US GAAP is to be determined under the Dispute Process.

2. Sale and Purchase

2.1 **Agreement to sell and purchase**

Subject to clause 2.2, on the Completion Date:

(a) **Sale and purchase**

the Vendor is to sell, convey, assign and transfer and the Purchaser is to purchase the Assets and the Business; and

(b) **No liabilities assumed**

the Purchaser does not assume any liability of the Vendor, a Related Company or Esphion Japan other than as set out in this Agreement, with effect from the close of business on the Completion Date on the terms and conditions contained in this Agreement.

2.2 **Nomination**

(a) The Vendor acknowledges and agrees that the Purchaser may, simultaneously with signing this Agreement, nominate an alternate purchaser (the **Permitted Nominee**) which is a wholly owned and controlled New Zealand subsidiary of the Purchaser, to purchase the Tangible Assets or a portion thereof, in place of the Purchaser, pursuant to this Agreement on the terms set out in this clause 2.2.

(b) Notwithstanding any such nomination the Purchaser shall remain responsible for all of the Purchaser's obligations under this Agreement.

(c) Such nomination shall only take effect upon the Purchaser delivering to the Vendor a signed deed of adherence in Agreed Form under which the Permitted Nominee agrees to be a party to and liable under this Agreement for the Purchaser's obligations in relation to the acquisition of the Tangible Assets and the offer of employment to the Existing Employees under clause 11.

(d) With effect from nomination in accordance with this clause 2.2, the Permitted Nominee may enforce this Agreement and exercise any rights of the Purchaser under this Agreement in relation to the Tangible Assets and the Existing Employees, as if it were a party to it in place of the Purchaser, provided that no claim may be made by the Permitted Nominee to the extent that the claim would not have been able to be made by the Purchaser if no nomination had occurred under this clause. For the avoidance of doubt, the Vendor agrees that if a clause in this Agreement provides that the Purchaser is able to claim against the Vendor for any claim made against, or liability incurred, by the Purchaser in relation to the Tangible Assets and the Existing Employees, then, on and from nomination in accordance with this clause 2.2, the Permitted Nominee is able to claim against the Vendor in accordance with that clause for any corresponding claim made against, or corresponding liability incurred, by the Permitted Nominee.

3. Conditions

3.1 **Completion is conditional**

Completion of this Agreement is subject to the full and complete satisfaction of the Conditions.

3.2 **Fulfilment of Conditions**

The date for satisfaction of each Condition is the relevant condition satisfaction date for that Condition as set out alongside that Condition in Schedule 4 or such later date as the parties may agree in writing.

3.3 **Reasonable endeavours**

The Vendor and the Purchaser will each use reasonable endeavours to procure the satisfaction of the Conditions and each will from time to time upon request from the other keep the other fully informed as to progress in procuring satisfaction of the Conditions. The obligations under this clause 3 do not require any party to pay money, other than customary adviser and registration fees and charges, provide any other consideration or incur any liability, actual or contingent, in order to satisfy the Conditions.

3.4 **Effect of failure to satisfy Conditions**

If the Conditions are not satisfied or (to the extent that they are capable of waiver), waived by the party for whose benefit they are inserted (as set out alongside each Condition in Schedule 4) by the condition satisfaction date specified alongside each Condition in Schedule 4, then either the Vendor or the Purchaser may terminate this Agreement by notice in writing to the other.

3.5 **Consequences of Termination and Cancellation**

If this Agreement is terminated or cancelled under clause 3.4 or clause 15.13:

(a) except as set out in clause, 19, 23 and 29, this Agreement will be of no further force and effect; and

(b) the parties will be released from their obligations under this Agreement and no party will have any claim against the other parties arising under or in connection with such termination other than in respect of any breach of this Agreement occurring before such termination.

4. Purchase Price and apportionments

4.1 **Amount**

The Purchase Price for the purchase of the Assets and the Business comprises:

(a) USD3,500,000 plus GST (if any) being the:

(i) Tangible Asset purchase price plus GST (if any) (the **Tangible Asset Purchase Price**); and

(ii) the Intangible Asset purchase price plus GST (if any) (the **Intangible Asset Purchase Price**),

each of which is payable at Completion by the Purchaser; and

(b) subject to certain conditions being satisfied as described in clause 5.1, a contingent payment of up to USD2,000,000 plus GST (if any), which, if payable, will be satisfied by a payment to the Vendor in accordance with clause 5,

subject to any adjustment in accordance with any provision of this Agreement.

4.2 **Payment of the Purchase Price**

(a) The Tangible Asset Purchase Price and the Intangible Asset Purchase Price are payable at Completion by the Purchaser in the following manner:

(i) the Escrow Amount is payable by the Purchaser to the Escrow Agent in accordance with clause 18.1(a); and

(ii) the portion of the Purchase Price that exceeds the Escrow Amount is payable by the Purchaser to the Vendor.

(b) The payment referred to in paragraph 4.1(b) is payable in accordance with clause 5.

4.3 **Allocation of Purchase Price**

(a) The portion of the Purchase Price payable pursuant to clause 4.1(a)will be allocated between the Assets as follows:

(i) for Fixed Assets – USD equivalent on Completion Date of NZD63,518;

(ii) for the Leased Equipment – USD1.00;

(iii) for the Trade Debtors – the lower of the USD equivalent book value or USD equivalent net realisable value as shown in the Business Records, determined at the Completion Date;

(iv) for the Business Agreements – USD0.00;

(v) for the Business Records – USD1.00;

(vi) Stock – the lower of the USD equivalent cost or USD equivalent realisable market value as shown in the Business Records, determined at the Completion Date;

(vii) for the Intellectual Property Rights – USD2,700,000;

(viii) for Goodwill – the balance of the portion of the Purchase Price payable pursuant to clause 4.1(a); and

(b) the portion of the Purchase Price comprising any Earn Out Payment payable as contemplated by clause 4.1(b), the amount of that Earn Out Payment will be attributed to Goodwill.

4.4 **Apportionments**

(a) All Prepayments and rent, rates, power, telephone, water, equipment rental payments and other outgoings of a periodic or recurring nature (but excluding insurance premiums, normal employee costs (including wages, salary, employee benefits, income tax deductible under the PAYE system, FBT, ACC or equivalent premiums)) must be apportioned between the Vendor and Purchaser (or the Permitted Nominee) as at 5pm on the Completion Date.

(b) All payments required by this clause 4.4 are to be calculated by the Purchaser (or the Permitted Nominee) and agreed by the Vendor and set out in a statement (**Apportionment Statement**). All figures in the Apportionment Statement and all calculations required pursuant to this clause 4.4 are to exclude GST.

(c) The Vendor will deliver the Apportionment Statement together with all supporting records, invoices and workings to the Purchaser on or before the date 15 Business Days after the Completion Date. All payments required to be made by the Apportionment Statement will be made by the Vendor or the Purchaser (or the Permitted Nominee) (as the case may be) on or before the date 30 Business Days after the Completion Date. The Purchaser will provide the Vendor and its agents with reasonable access to its records in order to enable the Vendor to prepare the Apportionment Statement.

(d) Any late invoices received by the Vendor or the Purchaser following the payment under sub-clause (c) above will be treated pursuant to the provisions of this clause 4.4, *mutatis mutandis*.

(e) Any dispute in relation to the Apportionment Statement and any payment required under this clause 4.4 will be resolved in accordance with clause 5.7.

4.5 **Cash Payments**

All payments to be made by the parties under this Agreement will be made against the submission of a valid invoice on the due date in same day cleared funds and free of any deduction, withholding, set-off, counter-claim, restrictions or conditions except to the extent the deduction or withholding is required by law.

For the purposes hereof unless directed otherwise by the Vendor in writing and at least seven Business Days prior to the appointed time of payment, all payments to the Vendor will be made to:

Account number: 107599 USD 374001
Swift Code: WPACNZ2W
Westpac Trust
219 McKinnon Drive
Albany
New Zealand

For the purposes hereof, all payments to the Purchaser will be made to:

Account number: 008200/04
Swift code: LUMIILITXXX
Bank Leumi Le-Israel B.M.
Branch No. 744
Ra’anana
Israel

4.6 **Core acquisition price**

For the purposes of the financial arrangements rules in the Income Tax Act 2004, the parties agree that:

(a) they are independent parties dealing at arm’s length with each other in relation to the sale and purchase contemplated by this Agreement;

(b) the extended settlement arrangements and payment of the Purchase Price arise solely because of the uncertainty of the parties in relation to the future earnings of the Business which necessitates the need for the earn out arrangements set out in clause 5; and

(c) the Total Consideration is the lowest price the parties would have agreed for the sale and purchase of the Business and Assets, on the Agreement Date, if payment would have been required in full at the time the first right in the contracted property (being the Assets and the Business) was transferred and does not include any capitalised interest; and

(d) the Total Consideration is the value of the Assets and the Business; and

(e) they will compute their taxable income for the relevant period on the basis that the Total Consideration includes no capitalised interest and will file their tax returns accordingly.

4.7 **Purchase Price conversion rate**

In relation to the Purchase Price referred to in clause 4.1, for the purpose of determining the GST payable on all or any part of the Purchase Price, the USD amounts will be converted into NZD at the buy rate quoted by the Bank of New Zealand as at 9 am on the Completion Date.

5. Earn Out

5.1 **Earn Out Conditions**

The Purchaser may set off from payment of any Earn Out Payment, any amount that has either been settled or agreed or is otherwise an amount claimed in good faith by the Purchaser as damages for breach of any of the Vendor's obligations under this Agreement, including the Warranties, or for breach of the Key Shareholders' Warranties and the non-compete covenants contained in clause 12.

5.2 **Earn Out Amount Calculation**

(a) The Purchaser will pay to the Vendor an amount calculated in accordance with the following formula:

EOA = (USD 0.8 x A)

Where:

EOA is the Earn Out Amount in USD.

A is the amount of Qualified Net Revenues recognized by the Purchaser during the period commencing 1 January 2008 and ending 31 December 2008.

If the Qualified Net Revenues are recognized from the sale of the Vendor's Products in combination with the Purchaser's Products, the related Earn Out Amount will be calculated based on the following formula:

QNRA = B x (C/(B + D))

Where

QNRA is the Qualified Earn Out Amount in USD.

B is the Vendor's Product price as quoted in the Purchaser's then current price list.

C is the Net Revenues recognized by the Purchaser in consideration for the sale of the combined solution of the Vendor's Product within the Purchaser's Product.

D is the Purchaser's Product price as quoted in the Purchaser's then current price list

(b) The Purchaser will pay to the Vendor an additional amount of Purchase Price plus GST (if any) calculated in accordance with this clause 5.2(b). If the Purchaser recognizes, during the Earn Out Period, revenues according to US GAAP from the sale of the Vendor's Products, and such revenues are collected within six months from the expiration of the Earn Out Period (the **Additional Qualified Net Revenues**), the Vendor shall be entitled, notwithstanding the definition of "Net Revenues", to EOA (as defined in accordance with clause 5.2(a)) with respect to the Additional Qualified Net Revenues. Seventy-five percent (75%) of the Additional Qualified Net Revenues will be paid on a quarterly basis within 15 Business Days from the announcement by the Purchaser of its financial results of operations of that calendar quarter, and the remaining balance of twenty-five percent (25%) will be applied to the Retention Amount under clause 5.6 below.

(c) The Earn Out Amount shall not exceed USD2,000,000 plus GST (if any). If the calculation of the Earn Out Amount under clause 5.2(a) produces an Earn Out Amount greater than USD2,000,000 plus GST (if any), the Purchaser is:

(i) only obliged to pay to the Vendor the amount of USD2,000,000 plus GST (if any); and

(ii) not obliged to pay the balance of the Earn Out Amount as calculated in accordance with clause 5.2(a).

5.3 **Calculation of the Earn Out Amount**

(a) The Purchaser will deliver to the Vendor:

(i) a statement of Qualified Net Revenues for the Earn Out Amount;

(ii) the calculation of the Earn Out Amount and working papers (which must include details of the relevant calculation and the inputs into that calculation);

(iii) copies of all purchase orders and invoices of the Purchaser through the Earn Out Period which reflect the sale of the Vendor's Products,

no later than 20 days prior to the Earn Out Payment Date.

(b) In the event that the Vendor disagrees with the calculation of the Earn Out Amount, it must, within 30 days of receipt of the information referred to in clause 5.3(a), give notice to the Purchaser of such disagreement (**Earn Out Calculation Notice**). An Earn Out Calculation Notice must include full details of the reasons for such disagreement (including working papers). The Purchaser shall ensure that the Vendor or the Vendor's accountants are given access to all additional information that they may reasonably require to enable the Vendor to make its decision whether to agree or disagree with the calculation of the Earn Out Amount, subject to the Vendor and the Vendor's accountants signing a confidentiality undertaking in the form set out in Appendix 7.

(c) Upon receipt of an Earn Out Calculation Notice, the Purchaser and the Vendor will use their reasonable endeavours to agree on the Earn Out Amount. Failing agreement by the parties within 5 days of the date of the Earn Out Calculation Notice, the matter will be resolved in accordance with clause 5.7.

(d) The Vendor is entitled to disagree with the calculation of the Earn Out Amount if the Vendor reasonably believes that the Purchaser has in average discounted or offered rebates or similar incentives affecting the prices of the Vendor's Products (by region), which are adversely disproportionate to the average discount, rebate or similar incentive offered in respect of the Purchaser's Products (by region) and may include such matter within the Earn Out Calculation Notice. If the expert appointed pursuant to clause 5.7 determines that the average discount offered,

rebate or similar incentive affecting the prices of the Vendor's Products are disproportionate to the average discount, rebate or similar incentive offered in respect of the Purchaser's Products (by region), the Earn Out Amount shall be increased or decreased by the expert to the extent the expert determines that the Vendor's Products and the Purchaser's Products had different average discounts, rebates or similar incentives according to listed prices (by region).

5.4 **Earn Out Payment**

(a) On the Earn Out Payment Date, the Purchaser must pay to the Vendor, against the submission in advance of a valid invoice, an amount equal to the Earn Out Amount, less the Retention Amount and any amount withheld or offset in accordance with clause 5.1 (the **Reduced Amount**).

(b) If an Earn Out Calculation Notice is issued after the Earn Out Payment, then:

(i) to the extent the Purchaser and the Vendor agree, the difference between (1) the Reduced Amount paid pursuant to clause 5.4(a) and (2) the amount agreed under clause 5.3(c) less the Retention Amount and any amount withheld or offset in accordance with clause 5.1, shall be paid against the submission of a valid invoice within seven Business Days of such agreement by relevant party; or

(ii) if there is a Dispute, the amount shall be paid against the submission of a valid invoice within seven Business Days following the decision made pursuant to clause 5.7.

5.5 **Recording Net Revenues**

The Purchaser will maintain adequate accounting and revenue tracking processes and procedures so that the Purchaser can readily identify and record the Qualified Net Revenues during the Earn Out Period.

5.6 **Payment of the Adjusted Retention Amount**

(a) On the Retention Payment Date, or if there is a Dispute, within seven Business Days of the expert issuing its decision under clause 5.7, the Purchaser must pay to the Vendor against the submission in advance of a valid invoice the Adjusted Retention Amount calculated in accordance with clause 5.6(b).

(b) The amount payable by the Purchaser to the Vendor on the Retention Payment Date is an amount determined by the following formula (the **Adjusted Retention Amount**):

ARA = RA - X+ Y

Where:

ARA is the Adjusted Retention Amount.

RA is the Retention Amount.

X is the amount of any Warranty Claim or other claim for damages made in good faith by the Purchaser in accordance with this Agreement.

Y is the interest earned on amount equal to the Retention Amount less the interest earned on X as from the date of the notification of the Warranty Claim related to X.

(c) If any Warranty Claim is not fully successful the Purchaser will pay the Vendor the amount of interest that would have been earned on such amount of Warranty Claim.

(d) The interest will be calculated based on the regular interest rate the Purchaser earns for deposits in an interest bearing deposit in commercial banks, net of any withholding taxes.

(e) If as a result of adjustments to the Retention Amount pursuant to this clause 5.6, the Adjusted Retention Amount is nil or a negative number, the Purchaser is not required to make any payment to the Vendor on the Retention Payment Date.

(f) Any dispute between the Vendor and the Purchaser regarding the Retention Amount or the Adjusted Retention Amount will be resolved in accordance with clause 5.7.

5.7 **Disputes**

(a) If a difference or dispute arises between the Vendor and the Purchaser relating to the Earn Out Amount as calculated under clause 5.2 or the Apportionment Statement, and the dispute is not resolved within 10 days after arising, either of them may provide a written notice to the other setting out the basis of the dispute (**Dispute Notice**) and the matter in dispute shall be determined in accordance with this clause 5.7.

(b) Upon the issue of a Dispute Notice, the dispute referred to in that notice (the **Dispute**) shall be immediately referred to, and finally resolved by, an expert who shall be appointed by the Vendor and the Purchaser. In the event that those parties cannot agree on an expert within 10 days of the Dispute Notice, the expert (who shall be from an objective (disinterested) firm of Chartered Accountants) shall be appointed by the President for the time being of the New Zealand Institute of Chartered Accountants on the application of either the Vendor or the Purchaser. The following provisions shall apply to the referral:

(i) the Vendor and the Purchaser shall each bear their own costs and expenses in connection with the referral, and all costs and expenses of the expert in determining the Dispute shall be borne as the expert may determine;

(ii) in the absence of manifest error, a determination by the expert of any matter pursuant to this clause 5.7 shall be final and binding on the parties;

(iii) the expert's terms of reference shall be instructed to determine the matters in dispute within 30 days of his appointment; and

(iv) the parties shall each provide the expert with all information which the expert reasonably requires and the expert shall be entitled (to the extent he considers appropriate) to base his determination on such information and on the accounting and other records of each party.

(c) Any monies referred to in the relevant decision of the expert shall be due and payable on the date falling seven Business Days after such notification of the expert's decision.

5.8 **Winding Up of Purchaser**

If an Event of Default occurs in relation to the Purchaser prior to the Earn Out Payment Date then unless that Event of Default is remedied within 14 days to the reasonable satisfaction of the Vendor, the Purchaser will immediately pay to the Vendor the difference between USD 5,500,000 and any part of the Purchase Price already paid to the Vendor by the Purchaser.

5.9 **Access to information during Earn Out**

During the Earn Out Period the Purchaser undertakes to the Vendor that, subject to the Vendor entering into the confidentiality agreement set out in Appendix 7, the Purchaser will deliver to the Vendor on a quarterly basis within 20 days following the announcement of its quarterly results of operations, an estimate of revenues related to the Vendor's Products that were recognized during that quarter. For avoidance of doubt, the final calculation of the Earn Out Amount will be made pursuant to clause 5.2 and the Vendor is restricted from using the aforementioned reports as supporting documents regarding the calculation of the Earn Out Amount.

6. Pending Completion

6.1 **Operation of Business**

Pending Completion the Vendor must, unless it has the prior written consent of the Purchaser (which will not be unreasonably withheld or delayed) to act otherwise:

(a) **Operate Business**

operate and conduct the Business in the ordinary course as has been disclosed to the Purchaser and maintain the goodwill of the Business in accordance with good business practice;

(b) **Not acquire or dispose of Assets**

not acquire any Asset (whether by purchase or lease) (other than in the normal course of trading and on arms-length commercial terms for full value) or dispose of any Fixed Asset or Intellectual Property Rights other than licences of Intellectual Property Rights granted in the ordinary course of business;

(c) **Notify Purchaser**

promptly notify the Purchaser of any events coming to the Vendor's knowledge which may be a Material Adverse Event;

(d) **Agreements**

not, in respect of the Business, enter into any agreement or other commitment except for agreements with customers and suppliers in the ordinary course of business;

(e) **Legal matters**

promptly notify the Purchaser of any legal claims, proceedings or investigations which may occur, be threatened, brought, asserted or commenced against the Vendor or its directors in relation to the Business;

(f) **Employees**

not employ any new employees or terminate the employment of any employee except for the termination of any employee's employment for breach, and not to change the terms of employment of the Existing Employees;

(g) **Related party transactions**

not enter into any agreement or transaction with any of its shareholders or their Related Companies, other than the provision of loans by the Vendor's shareholders to the Vendor or the issue of securities by the Vendor to its shareholders or as required under this Agreement;

(h) **Indebtedness**

not, except in the ordinary course of business, enter into any agreement to borrow or increase the level of borrowings under any existing facility with any party other than the provision of loans by the Vendor's shareholders to the Vendor; and

(i) **Insurance**

keep in force (and not prejudice in any way) any existing policies of insurance covering the Business and Assets.

6.2 **Risk and damage**

(a) **Material Damage**

(i) The Assets shall be at the sole risk of the Vendor until Completion occurs at the close of business on the Completion Date and will then be at the sole risk of the Purchaser.

(ii) If, before Completion any Fixed Asset is lost, destroyed or damaged and that loss, destruction or damage has not been repaired, replaced or otherwise compensated for by an insurance policy by Completion, and the loss, destruction or damage is sufficient to be, in the Purchaser's reasonable opinion, a Material Adverse Event, the Purchaser may cancel this Agreement by notice in writing to the Vendor. If the Agreement is cancelled under this clause 6.2:

(A) except as set out in clauses 6.2(a)(ii), 19, 23, 29, this Agreement has no further effect; and

(B) the parties will be released from their obligations under it and no party will have any claim against the other parties arising under or in connection with such termination other than in respect of any breach of this Agreement occurring before such termination.

This right of cancellation is in addition to, and not limited by, any other rights or remedies of the Purchaser against the Vendor. If the Purchaser does not exercise its rights under this clause 6.2 (a), its other rights and remedies will not be prejudiced.

(b) **Immaterial damage**

If, before Completion any Fixed Asset with a replacement value for assets with the same or similar functionality in excess of USD5,000 is lost (individually or in the aggregate), destroyed or damaged and the loss, destruction or damage is, in the Purchaser's reasonable opinion, insufficient to be a Material Adverse Event, the Purchaser is to complete the purchase of the Business and Assets at the Purchase Price, less a sum equal to the amount of the diminution in value of the Fixed Assets. If the Purchaser and the Vendor cannot agree on the amount of the reduction in value of the Fixed Assets before the Completion Date, the amount of the reduction is to be determined under the Dispute Process.

6.3 **Access for transition**

The Vendor must ensure that from the Agreement Date, the Purchaser and its representatives will have such access as they may reasonably request during normal business hours to the Business and to the Vendor's employees, books of account, computerised records, agreements, Fixed Assets, Stock and all information relating to the Business. The Vendor must cause its directors, officers, employees, contractors, accountants and lawyers and other advisers to co-operate with and make all information relating to the Vendor, the Business and the Assets available to the Purchaser and its advisers in a full and timely manner.

6.4 **Breach of Warranty**

The Vendor undertakes with the Purchaser that:

(a) **Disclosure**

it will disclose immediately in writing to the Purchaser any matter or circumstance which may arise or become known to it after the Agreement Date and before Completion which does or may constitute a breach of any of the Warranties; and

(b) **No breach of Warranties**

pending Completion it will not do, or omit to do, or allow anything to be done, as a result of which any Warranty is or may be breached as at Completion.

6.5 **Dealings with third parties and exclusivity**

(a) The Vendor and the Covenantors must immediately terminate all discussions and negotiations with third parties in relation to the sale of the Business or any of the Assets and will procure that their agents also terminate any such discussions and negotiations.

(b) The Vendor will obtain from any such third parties the return of all due diligence information about the Business and the Assets in the possession of such parties, or obtain appropriate written confirmation from such parties that such information has been destroyed.

(c) Neither the Vendor nor the Covenantors (or anyone acting on their behalf) shall without the Purchaser's prior written consent (such consent to be given at the Purchaser's sole and absolute discretion) directly or indirectly, solicit, negotiate and/or accept offers for or enter into any transaction involving the sale of the Business or the Assets or the sale of the shares of the Vendor.

7. Completion

7.1 **Time and place**

Completion is to take place at 2 pm on the Completion Date at the offices of the Purchaser's Solicitors.

7.2 **Possession and title**

Possession of and title to the Assets and the Business is to be given and taken on the Completion Date. On the Completion Date the Vendor will, subject to clause 2.2,sell, convey, transfer and assign the Assets and the Business to the Purchaser and the Purchaser will take over the Assets and the Business and the management of the Business. On Completion, the sale, transfer, conveyance and assignment is to have effect as at the close of business on the Completion Date.

7.3 **Delivery of Assets on Completion Date**

On the Completion Date the Vendor must deliver and make available to the Purchaser (or the Permitted Nominee (as relevant)), at the Leasehold Property (or at such other place as any Asset may be), possession and control of the Business and the Assets (other than those to which the provisions of clause 7.4 relate) and the Business Records. Where the Vendor is required to have access for its own accounting and tax purposes to any original Business Records following Completion which have been delivered to the Purchaser at Completion under this clause 7.3, the Purchaser is to allow the Vendor to have reasonable access to such Business Records and to take such copies of those Business Records, as reasonably required by the Vendor solely for that purpose.

7.4 **Delivery of documents on Completion**

At Completion the Vendor must deliver to the Purchaser:

(a) **Certificate**

a certificate in Agreed Form signed on behalf of the Vendor by Mark Edwards, the Chief Executive Officer of the Vendor, confirming that so far as he is aware after making reasonable enquiry (whether or not that enquiry is actually made) and there shall be deemed to be included the knowledge of matters that he ought to be aware of by reason of his position and area of expertise, into the relevant matter) the Warranties are and will not be breached as at Completion and that the Vendor is not in breach of any other provision of this Agreement as at Completion;

(b) **Releases**

releases of the general security agreement dated 7 November 2007 in favour of the Key Shareholders and all registered Encumbrances over the Assets and the Business;

(c) **List of Assets**

a list of the Fixed Assets and Intellectual Property, the book value of each such Asset (cost and accumulated depreciation) as at the Completion Date with, in the case of the Fixed Assets, a description of their location;

(d) **Leasehold Property**

in respect of the Leasehold Property, a deed of assignment of lease between the Vendor, the Purchaser or the Permitted Nominee and the landlord of the Leasehold Property in Agreed Form duly executed by the Vendor and, if available at Completion, the landlord;

(e) **PABX Lease**

if available from Technology Rentals Limited, necessary documentation to assign all of the rights and obligations of the Vendor under the Lease Agreement between Technology Rentals Limited and the Vendor for a PABX Alcatel telephone system to the Purchaser;

(f) **Intellectual Property**

deeds of assignment of the Trade Marks, Patents and other Intellectual Property Rights to the Purchaser in Agreed Form and duly executed by the Vendor;

(g) **Websites**

documentation necessary to transfer ownership of the Websites from the Vendor to the Purchaser or the Permitted Nominee in Agreed Form duly executed by the Vendor;

(h) **Original Agreements**

copies (and original copies if available) of the agreements leasing the Leased Equipment and the Business Agreements (if in writing) which may be delivered by leaving them at the Leasehold Property;

(i) **Termination of Distribution Agreement**

documentation necessary to terminate both the International Reseller Agreement between the Vendor and LINC Media Inc. dated 1 April 2005 and the Business Development Consultancy Agreement between the Vendor and Japan Inc. Communications dated 7 October 2004;

(j) **Trade Debtors**

a list of the Trade Debtors of the Business as at the Completion Date, including the full name and contact addresses of each trade debtor and the relevant amounts to or by such persons;

(k) **Stock**

a list of the Stock as at the Completion Date;

(l) **Management Accounts**

copies of the Management Accounts, except for the Management Accounts for the period commencing on 1 October 2007 and ending on the Completion Date, which will be delivered pursuant to clause 21;

(m) **Invoice**

provide valid invoices for the portion of the Purchase Price to be paid on the Completion Date;

(n) **Conditions**

evidence satisfactory to the Purchaser that the Conditions in paragraphs (a) and (b) of Schedule 4 has been satisfied; and

(o) **Escrow Deed**

a copy of the Escrow Deed signed by the Vendor and No 8 Ventures Management Limited.

All documents required to be delivered by the Vendor as set out in this clause 7 must be in a form satisfactory to the Vendor and the Purchaser and their legal counsel, each acting reasonably.

7.5 **Purchaser's obligations**

On Completion, after the Vendor has complied with clauses 7.3 and 7.4 the Purchaser must deliver to the Vendor:

(a) **Payment of Purchase Price**

pay or procure the payment of the Tangible Assets Purchase Price and the Intangible Assets Purchase Price to the Vendor and the Escrow Agent in the relevant proportions described in clause 4.2 in cleared funds;

(b) **Intellectual Property**

deeds of assignment of the Trade Marks, Patents and other Intellectual Property Rights to the Purchaser in Agreed Form and duly executed by the Purchaser;

(c) **Websites**

documentation necessary to transfer ownership of the Websites from the Vendor to the Purchaser or the Permitted Nominee duly executed by the Purchaser or the Permitted Nominee;

(d) **Leasehold Property**

in respect of the Leasehold Property, a deed of assignment of lease between the Vendor, the Purchaser or the Permitted Nominee and the landlord of the Leasehold Property in Agreed Form duly executed by the Purchaser;

(e) **Conditions**

evidence satisfactory to the Vendor that the Condition in paragraph (b) of Schedule 4 has been satisfied; and

(f) **Legal Opinion**

a legal opinion in the Agreed Form signed by the Purchaser's legal counsel in Israel; and

(g) **Escrow Deed**

a copy of the Escrow Deed signed by the Purchaser and the Escrow Agent.

7.6 **Reseller Agreement**

After Completion, the Purchaser will use its reasonable endeavours to agree with Esphion Japan the form of and enter into the Reseller Agreement.

8. Default

8.1 **Vendor in default**

If the Vendor does not fulfil the Vendor's obligations under clause 7 then, without prejudice to any other rights or remedies available to the Purchaser, the Purchaser may:

(a) **Specific performance**

sue the Vendor for specific performance; or

(b) **Cancel**

cancel this Agreement and sue the Vendor for damages.

8.2 **Purchaser in default**

If the Purchaser does not fulfil the Purchaser's obligations under clause 7 then, without prejudice to any other rights or remedies available to the Vendor, the Vendor may:

(a) **Specific performance**

sue the Purchaser for specific performance; or

(b) **Cancel**

cancel this Agreement and sue the Purchaser for damages.

8.3 **Default Interest**

If any party does not pay any sum payable by it under this Agreement as and when due and in the manner provided in this Agreement, it must pay Default Interest on that unpaid sum. Default Interest is to accrue on any unpaid sum from day to day from the due date up to the date of actual payment, before and after judgment. Interest on overdue payments is to be capitalised monthly. The demand for or payment of Default Interest is not in substitution for, or to the exclusion of, any rights or remedies otherwise available to a party under this Agreement.

9. Vendor Earn Out Protection

9.1 **Positive Covenants**

From the Completion Date until the expiry of the Earn Out Period, the Purchaser will, and the Purchaser will procure each Group Company to, use best commercial endeavours to promote and enhance the Business to the extent the same does not conflict with the Purchaser's then current business.

10. Assignment and related matters

10.1 **Assignment of Business Agreements**

With effect from Completion, the Vendor assigns, to the extent permitted by law, the benefit of all Business Agreements. Where for any reason the assignment evidenced by this clause 10.1 is void or unenforceable the Vendor is, to the extent permitted by law, to hold the benefit of any Business Agreements not assigned or novated on Completion for the Purchaser and the Purchaser must properly perform the obligations of the Vendor under those Business Agreements (to the extent that those obligations arise after the Completion Date) on the Vendor's behalf. Where for any reason the assignment evidenced by this clause 10.1 is void or unenforceable the Vendor is to on receipt of a written notice by the Purchaser and subject to being indemnified by the Purchaser take such reasonable steps as are necessary to enforce any Business Agreement in accordance with the Purchaser's reasonable instructions.

10.2 **Indemnity by Vendor**

The Vendor indemnifies the Purchaser against any liability or loss arising directly from, and any costs, damages, losses, charges or expenses actually incurred by the Purchaser concerning, any failure by the Vendor to perform all obligations under, or comply with the terms of, the Business Agreements for the period before Completion. The Vendor agrees to account to the Purchaser for all sums received by the Vendor in respect of Business Agreements which relate to the period following Completion.

10.3 **Indemnity by Purchaser**

The Purchaser must assume, and fully and effectively perform, all obligations arising under the Business Agreements as and from Completion and must indemnify the Vendor against all liability or loss arising directly from, and any costs, damages, losses, charges or expenses actually incurred by the Vendor concerning, any failure by the Purchaser to perform all obligations under, or comply with the terms of, any of the Business Agreements following Completion and the lease of the Leasehold Property.

10.4 **Transfer of communication numbers**

The Vendor must use its reasonable endeavours to ensure that all of the fixed line telephone and facsimile numbers, mobile phone numbers of the Existing Employees and other communications owned by the Vendor and used by the Business are transferred to the Purchaser with effect from Completion.

10.5 **Insurance**

The Purchaser will not have any rights or obligations concerning any insurance policies held by the Vendor concerning the Business or the Assets.

10.6 **Pre-Completion Assistance:**

The Purchaser:

(a) must, immediately after the Agreement Date, use all reasonable endeavours to assist the Vendor to secure in respect of the Leasehold Property, the consent of the landlord counter-party to the assignment of the lease of the Leasehold Property by providing such financial and operational information as the landlord counterparty may request;

(b) must, immediately after the Agreement Date, without limiting its obligations under clause 10.6(a), sign a deed of assignment of lease in the ADLS standard form and if making the nomination pursuant to clause 2.2 for the Permitted Nominee to be the assignee, have the Purchaser enter into a guarantee in the ADLS standard form.

11. Employees

11.1 **Offer of employment**

(a) As soon as practicable after the Agreement Date the Vendor will consult with each of the Existing Employees regarding the Vendor's entry into this Agreement and assist the Purchaser with delivery of the Purchaser's Offer (as defined below) to each of the Existing Employees.

(b) The Purchaser or the Permitted Nominee will make a written offer to each Existing Employee, in a form approved by the Vendor, offering to employ each Existing Employee with effect from the close of business on the Completion Date (the **Purchaser's Offer**) on terms that are no less favourable to them than their existing terms of employment although the Purchaser's Offer will include equity based incentives under the

Purchaser's existing incentive plans and the Vendor acknowledges that these equity based incentives may not equate with the private company equity based incentives currently offered by the Vendor to the Existing Employees.

11.2 **Reasonable endeavours**

Each of the Vendor and the Purchaser are to use reasonable endeavours to persuade all of the Existing Employees receiving a Purchaser's Offer to accept employment with the Purchaser on the terms specified in the Purchaser's Offer. One Business Day before Completion, the Purchaser must give notice to the Vendor of all Employees who have accepted the Purchaser's offer of employment.

11.3 **Benefits**

The Vendor shall pay to each Existing Employee a sum equal to the value of the Leave Benefits and all due bonuses, wages and salaries (prorated) on or before the Completion Date.

11.4 **Liability to Employees**

If the Purchaser or the Permitted Nominee does not make the Purchaser's Offer to the Existing Employees in accordance with clause 11.1, the Purchaser will, subject to receipt of evidence of the termination of the Existing Employees' employment with the Vendor, indemnify the Vendor for an amount equal to all the total of all wages, salaries and benefits payable and any leave entitlements payable to the Existing Employees for the period of notice required to be given to each Existing Employee to terminate such employees' employment with the Vendor or in lieu of such notice any other payment to which the Employee is lawfully entitled on termination of their employment.

11.5 **No third party rights**

Nothing in clause 11 creates any third party beneficiary rights (for the purposes of the Contracts (Privity) Act 1982) in any Existing Employee.

11.6 **Immigration Assistance**

The Vendor will provide the Purchaser with all reasonable assistance required to transfer the sponsorship of any Existing Employee for immigration purposes from the Vendor to the Purchaser.

11.7 **Seconded Employee**

(a) **Seconded Employee**

For the period from the Completion Date until the date falling three months thereafter (the **Transition Period**) or any such longer period as agreed between the Vendor and the Purchaser, the Vendor will use reasonable endeavours to make Alexander Kharichev (the **Seconded Employee**) available to the Purchaser (for so long as he is an employee of the Vendor) for the provision of services to the Business.

(b) **Location**

While providing the services, the Seconded Employee will continue to be based at the premises at which the relevant Seconded Employee was based at the Agreement Date.

(c) **Termination of employment**

Subject to clause 11.7(d), the Vendor will not be required to make the Seconded Employee available to the Purchaser where the Seconded Employee is taking leave or where the employment of the Seconded Employee terminates. The Purchaser shall continue to pay for the services where the Seconded Employee is on leave. Any such leave will be coordinated with and approved by the Purchaser.

(d) **No termination**

During the first two months of the Transition Period, the Vendor will not, without the prior consent of the Purchaser (such consent not to be unreasonably withheld), terminate the employment of the Seconded Employee, unless that termination is for breach. The Purchaser may at any time after the first six weeks of the Transition Period terminate the provision of the Seconded Employee's services by giving the Vendor five weeks notice in writing.

(e) **No warranty**

Neither the Vendor nor the Seconded Employee makes any warranty or representation regarding the skills or attributes of, or the quality of any services, information or documentation provided to the Purchaser by, the Seconded Employee. The Vendor excludes all liability to the Purchaser or (howsoever arising) for any actions or omissions of the Seconded Employee.

(f) **No personal liability**

The Seconded Employee will not have any duty, responsibility or any other obligation whatsoever to the Purchaser in their personal capacity under this Agreement.

(g) **Indemnity**

The Purchaser indemnifies the Vendor and the Seconded Employee against any and all claims or liabilities that may be incurred or sustained by, or made against, the Vendor or the Seconded Employee as a direct or indirect result of any actions or omissions of the Purchaser in respect of the Seconded Employee or the actions or omissions of the Vendor or the Seconded Employee at the request of the Purchaser in respect of the Seconded Employee.

(h) **Continued employment**

Notwithstanding anything in this Agreement, the Vendor will continue to be the employer of the Seconded Employee until such time as his employment with the Vendor terminates.

(i) **Charges**

The Vendor will charge the Purchaser for providing services during the Transition Period, including any amount equal to the cost to the Vendor of employing the Seconded Employee, and any salary, wages, income tax deductible under the PAYE system, FBT, ACC or equivalent premiums and all employee leave benefits accruing during the Transition Period (including without limitation, annual leave or long service leave) and any payment in lieu of working notice period plus GST (if any).

(j) **Invoices**

The Vendor will issue a Tax Invoice prior to the eighth day of the month during the Transition Period for services provided by the Seconded Employee in that month (such invoice being for service 2 weeks in arrears and 2 weeks in advance). The Vendor may also include in that invoice an amount to reimburse the Vendor for any reasonable out-of-pocket costs incurred by it in providing the services.

(k) **Payment**

The Purchaser will pay to the Vendor the amount specified in the Tax Invoice, together with the GST payable (if any) on or before the tenth day of the month (or the next Business Day if such day is not a Business Day) after the date of the Tax Invoice.

12. Non-competition

12.1 **Undertakings**

Each of the Vendor and the Covenantors (in this clause 12 called the Undertaking Parties) acknowledges that it will be receiving a material and significant financial benefit as a result of the purchase of the Assets and the Business by the Purchaser. Each of the Undertaking Parties acknowledges that the undertakings given by it in this clause 12 are an integral component of the purchase of the Business by the Purchaser and that the Purchaser would not be prepared to pay the Purchase Price for the Business unless those undertakings were given. As further consideration for the Purchaser agreeing to purchase the Assets from the Vendor on the terms contained in this Agreement:

(a) **Not compete**

the Vendor undertakes with the Purchaser that it will not (except with the prior written consent of the Purchaser) for a period of four years from the Completion Date, either solely or jointly with any person directly or indirectly carry on or be engaged or concerned or interested or in any way assist in any place in the world in the development, manufacture, marketing or sale of solutions and products for network protection which compete with the Vendor’s Products manufactured, sold or supplied by the Business as at this Agreement;

(b) **Not solicit employees**

each Undertaking Party undertakes with the Purchaser that it will not for a period of four years from the Completion Date, directly or indirectly for itself or on behalf of or in conjunction with any other person solicit, induce or encourage any of the Existing Employees or consultants of the Vendor to leave their employment with the Purchaser or engage, retain or hire any of the Existing Employees;

(c) **Confidential Information**

(i) Each Undertaking Party undertakes with the Purchaser that it will not (except with the prior written consent of the Purchaser) at any time after Completion use or disclose to any person any Confidential Information provided that this clause 12.1(c) shall not apply to the extent that:

(A) disclosure is required by law;

(B) the information is already in the public domain;

(C) the Vendor makes disclosure to its professional advisers for the purpose of seeking advice on this Agreement and the transactions contemplated by it;

(D) the Vendor makes disclosure to its professional advisers for the purpose of performing its obligations under this Agreement.

(ii) If a party is required to disclose any Confidential Information in accordance with 12.1(c)(i)(A), that party will immediately give notice of the proposed disclosure to the other parties before any such disclosure is made and will take all reasonable actions to limit the Confidential Information required to be disclosed.

12.2 **Exception**

Nothing in clause 12.1 prohibits, following Completion, an Undertaking Party holding as an investor only up to five per cent of the issued share capital, or any debentures or other non-voting securities, of any company the securities of which are listed on any recognised stock exchange.

12.3 **Undertakings independent**

Each undertaking contained in clause12.1 is to be read and construed independently of the other undertakings contained in clause 12.1 so that if one or

more should be held to be invalid as an unreasonable restraint of trade or for any other reason whatsoever then the remaining undertakings are to be valid to the extent that they are not held to be so invalid.

12.4 **Reasonable undertakings**

Each Undertaking Party acknowledges that:

(a) **Value of Assets and Business**

the value of the Assets and Business upon which the Purchase Price has been set and accepted by the Purchaser is dependent upon the Undertaking Parties each giving the undertakings contained in this clause 12;

(b) **Reasonable undertakings**

those undertakings are reasonable; and

(c) **Protection of Goodwill**

those undertakings have been given for the protection of the Purchaser in respect of the Goodwill.

12.5 **Modification**

If any undertaking is held invalid as an unreasonable restraint of trade or for any other reason but would have been valid if part of the wording had been deleted or the period reduced or the range of activities or area dealt with reduced in scope, those undertakings are to apply with those modifications necessary to make them valid and effective.

12.6 **Equitable relief**

Each Undertaking Party acknowledges that, if there is an alleged breach of this clause 12, the Purchaser may seek equitable relief in addition to damages. In any proceeding bought by the Purchaser against an Undertaking Party seeking equitable relief for a breach of this clause 12, the Undertaking Party may not claim that the breach is one which may not or ought not to be the subject of equitable relief.

12.7 **Assignment**

The Purchaser may assign the benefit of the undertakings contained in this clause 12, in whole or in part.

13. Business Names

13.1 **Use of Business Name**

None of the Vendor or the Covenantors, their Subsidiaries, any person controlled by the Vendor, the Key Shareholders or any of their Subsidiaries, whether individually or jointly, may, and the Vendor and LINC Media Inc. will, for so long as they directly or indirectly hold shares in Esphion Japan, procure that Esphion Japan does not at any time nine months after the Completion Date:

(a) **Use Business Names**

at any time after Completion (except with the prior written consent of the Purchaser) directly or indirectly use any Business Name or any other name utilised in the Business as part of its business name, or incorporated in any trade mark, brand, logo or other intellectual property or in any way hold themselves out as being associated with any business using such name except that Esphion Japan may continue to use the name "Esphion" for a period of up to nine months after Completion; or

(b) **Consent to others using Business Names**

consent to the use or adoption of the Business Names by any person.

13.2 **Change of Name**

(a) Within one Business Day after Completion, the Vendor will, and within ten Business Days after Completion the Vendor will procure that any subsidiary of the Vendor will, change their names to names that do not include any or a combination of the Business Names.

(b) Within nine months after Completion, the Vendor and LINC Media Inc, provided that they directly or indirectly hold shares in Esphion Japan, will procure that Esphion Japan changes it name to a name that does not include any or a combination of the Business Names.

14. Goods and services tax

14.1 **Consideration exclusive of GST**

Any consideration or payment obligation in this Agreement is exclusive of GST unless otherwise stated.

14.2 **Recovery of GST payable**

If under or in relation to this Agreement any supply of goods or services from one party (the **Supplier**) to another party (the **Recipient**) is a Taxable Supply and the consideration payable or to be provided for the supply is not expressed to be inclusive of GST, then the Recipient must pay to the Supplier, in addition to the consideration otherwise payable, an amount equal to the GST chargeable on that supply, provided that no payment will be required under this clause 14 until the Supplier has issued a Tax Invoice to the Recipient in respect of that supply.

14.3 Payment of GST

Except in respect of any GST payable on Completion in accordance with clause 7.5(a), any amount payable under clause 14.2 must be paid by the Recipient on the date that is five Business Days after the Supplier issues a Tax Invoice to the Recipient for that Supply.

15. Warranties

15.1 Warranties

The Vendor represents and warrants to the Purchaser in the terms of the Warranties in the knowledge that the Purchaser is entitled to rely on the truth of the statements contained in the Warranties.

15.2 Warranties repeated

Each of the Warranties is to be repeated on the Completion Date by reference to the facts and circumstances or awareness of the Vendor then existing.

15.3 Notice of Warranty claims

All Warranty Claims made by the Purchaser under this Agreement must be in writing and delivered to the Vendor and any notice under this clause 15.3 is to specify in reasonable detail the matter which gives rise to the breach, the nature of the breach and the amount claimed.

15.4 Claim thresholds

If the Vendor becomes liable to the Purchaser for breach of any Warranty:

(a) no amount shall be claimed by the Purchaser for breach of any Warranty unless the amount claimed exceeds USD50,000 in respect of an individual claim or series of related claims; or

(b) no amount shall be claimed by the Purchaser for breach of Warranty unless the aggregate of the amount then claimed and of all other claims made, or which would but for the provision of this clause have previously been made, exceeds USD150,000 upon the basis that, once such threshold has been exceeded, any claim so made may be for and in respect of all amounts claimed and not just in excess of USD150,000.

15.5 Period for Warranty Claims

The Purchaser may not make any Warranty Claims in respect of any Warranty after the end of the period of 24 months following the Completion Date.

15.6 Third party claim procedures

(a) If an event occurs or claim arises against the Purchaser (**Third Party Claim**) in relation to which the Purchaser will or is likely to make a Warranty Claim against the Vendor:

(i) the Purchaser shall give notice within ten Business Days thereof (including reasonable details) to the Vendor and not make any payment or admission of liability in respect of the Third Party Claim, or take any other steps which may in any way prejudice the defence of the Third Party Claim, without the prior written consent of the Vendor (such consent not to be unreasonably withheld or delayed) and subject to clause 15.6(b) otherwise act in accordance with the Vendor’s reasonable directions regarding negotiations, prosecution or defence of any Third Party Claim;

(ii) the Vendor may, with the prior written consent of the Purchaser (not to be unreasonably withheld or delayed), in the name of the Purchaser, assume full control and conduct all negotiations and prosecute or defend any proceedings relating to the Third Party Claim. For this purpose the Purchaser shall make available to the Vendor all such information, books and records, and give such other co-operation (including making available employees as witnesses), as the Vendor may reasonably require for the purpose. If the written consent of the Purchaser is not provided within 15 Business Days of receipt of a written request from the Vendor, the Purchaser shall have no liability in connection with the Third Party Claim whether pursuant to the Warranties or otherwise;

(iii) in relation to any dispute that the Vendor has control over under this clause 15.6, the Vendor will, prior to taking any action relevant to any Third Party Claim, consult with the Purchaser and its professional advisers (provided that such consultation does not cause undue delay) in relation to the conduct and progress of all such disputes resolution procedures, challenges or court proceedings and any related correspondence and negotiations, to keep the Purchaser and its professional advisers fully informed on this progress and, to provide the Purchaser and its professional advisers with copies of all relevant documents, including drafts. The Vendor, following such consultation, shall take into account all reasonable concerns and issues raised by the Purchaser in all action that is taken by the Vendor;

(iv) the costs of the negotiations and proceedings shall be borne by the Vendor.

(b) the Vendor in exercising the rights granted to it by this clause shall take account of all reasonable requests, including requests regarding not taking actions which may materially adversely affect the reputation of the Business.

15.7 Warranties qualified

Each of the Warranties is given subject to the following which shall prevent the Purchaser being entitled to claim that any of the Warranties have been breached:

(a) **Agreement**

any thing done, or omitted to be done, either under any express provision of this Agreement or after the Agreement Date at the request in writing of, or with the prior written approval of, the Purchaser;

(b) **Disclosure**

any matter, event, circumstance or information to the extent that it is:

(i) fairly disclosed in the Disclosure Material or the Disclosure Letter or in any document referred to in the Disclosure Materials or Disclosure Letter;

(ii) disclosed by public records at the New Zealand Companies Office or the New Zealand Personal Property Securities Register relating to the Vendor;

(c) **Knowledge**

any matter, event, circumstance or information known to the Purchaser or its advisers,

but is subject to no other qualification unless specifically provided for under this Agreement.

15.8 **Other Limitations**

The Vendor shall not be liable for any Warranty Claim for loss arising from a breach of Warranty:

(a) based on a contingent liability unless and until the contingent liability becomes an actual liability and is due and payable;

(b) to the extent that the relevant event, circumstance, loss, liability, cost or expenses would not have arisen but for:

(i) a breach of law or contract or wrongful act or omission by the Purchaser or any of its Related Companies after Completion; or

(ii) any obligation or commitment entered into or made after Completion by the Purchaser or any of its Related Companies

(c) if and to the extent that the relevant circumstance or amount has been or is made good, or recovered within 20 Business Days of the relevant circumstance arising by or paid to the Purchaser or its Related Companies;

(d) if and to the extent that the Warranty claim is in respect of any budget, forecast, estimate, projection, model, or other statement which relates to the future and any statement of opinion or statement of intent, including the basis of preparation of, assumptions for or reasonableness of any such matter;

(e) if and to the extent that such claim arises as a result of any legislation not in force at the Agreement Date which takes effect retrospectively;

(f) if and to the extent that such a claim arises as a result of a change after the date of this Agreement in any law or interpretation of any law or NZ GAAP;

(g) to the extent that the amount of such claim and the aggregate amount of all other Warranties Claims by the Purchaser would exceed an amount equal to the Purchase Price that has actually been paid by the Purchaser;

(h) to the extent of any saving to the Purchaser and its Related Companies in Taxation as a result of the relevant event, circumstances, loss, liability, cost or expense to which the claim relates;

(i) unless the Purchaser has begun court proceedings relating to the claim or the Vendor admits to the claim or the claim is settled, in each case, within 6 months of notification pursuant to clause 15.3; and

(j) if and to the extent that the Purchaser has failed to take all reasonable action to mitigate any loss suffered by the Vendor in respect of which a claim could be made.

15.9 **Reduction of Purchase Price**

Any monetary compensation received by the Purchaser as a result of any breach by the Vendor of any Warranty is to be in reduction and refund of the Purchase Price.

15.10 **Indemnity**

(a) The Vendor must indemnify and keep indemnified the Purchaser against any loss, damage, cost, expense, taxation or liability (including legal or other costs associated with the enforcement of this Agreement) suffered or incurred by the Purchaser arising directly from the breach of any Warranty or any other term of this Agreement.

(b) The Purchaser must indemnify and keep indemnified the Vendor against any loss, damage, cost, expense, taxation or liability (including legal or other costs associated with the enforcement of this Agreement) suffered or incurred by the Vendor arising directly from the breach of any term of this Agreement.

15.11 **Gross-up**

If any party is required by law to make any deduction or withholding from any sum payable by it to the other party under this Agreement and there is no equivalent corresponding Tax saving to the recipient, then the sum payable by the first party will be increased to the extent necessary to ensure that after the making of that deduction, withholding or payment the amount that person would have received and retained will be equal to the amount had no deduction, withholding or payment been made.

15.12 **Truth of the Warranties**

The Vendor acknowledges that the Vendor and the Purchaser have agreed that:

(a) **Truth of Warranties**

the truth of the statements contained in the Warranties; and

(b) **Fulfilment of obligations**

the fulfilment by the Vendor of all of its obligations under this Agreement,

are essential to the Purchaser.

15.13 **Cancellation**

If, pending Completion:

(a) **Breaches obligations**

the Vendor fails to perform any of the Vendor's material obligations or other obligation not remedied within 5 days under this Agreement;

(b) **Breaches Warranties**

any circumstances exist or arise which have the effect of giving rise to a Warranty Claim; or

(c) **Adverse circumstances**

the Vendor or the Purchaser becomes aware of any event or circumstance which in the reasonable opinion of the Purchaser will or is likely to be a Material Adverse Event,

the Purchaser may, at the Purchaser's absolute discretion, give the Vendor notice cancelling this Agreement at any time prior to Completion. This right of cancellation is in addition to, and not limited by, any other rights or remedies of the Purchaser against the Vendor. If the Purchaser does not exercise its rights under this clause 15.13 its other rights and remedies under this Agreement or at law will not be prejudiced provided that once Completion has occurred the Purchaser may not cancel this Agreement. Any notice given under this clause 15.13 is to be effective as against the Vendor if given to the Vendor.

15.14 **Acknowledgment by Purchaser**

The Purchaser acknowledges that:

(a) it has made its own independent enquiry and investigations in relation to the Assets and the Business and has entered into this Agreement in reliance on its own judgment and not in reliance on any warranties or representations of the Vendor (other than the Warranties and the Key Shareholders' Warranties);

(b) except for the Warranties and the Key Shareholders' Warranties and other obligations of the Vendor, the Key Shareholders and the Covenantors expressly provided in this Agreement, all express or (to the extent permitted by law) implied, or other representations or warranties of the Vendor, the Key Shareholders and the Covenantors in relation to the sale of the Business or Assets are expressly excluded;

(c) except for the Warranties and the Key Shareholders' Warranties and the other obligations of the Vendor, the Key Shareholders and the Covenantors expressly provided in this Agreement, neither the Vendor, the Key Shareholders and the Covenantors, nor their directors, officers, advisers or agents have made or make any representation, or have given or give any warranty (express or implied), as to the accuracy, content, completeness, value or otherwise of, nor have or accept any liability in respect of, any information (written, oral or otherwise) directly or indirectly provided, or made available to, or used by the Purchaser in connection with, the transactions evidenced by this Agreement, and to the extent permitted by law the Purchaser unconditionally waives any claim (whether arising in tort, in contract, by operation of law or otherwise) it may have against any of them in respect of such information.

15.15 **Updated disclosure**

The Vendor shall have the right to submit to the Purchaser, at any time prior to Completion, an updated disclosure letter containing disclosure of any facts, matters of circumstances occurring or coming to the awareness of the Vendor after the Agreement Date and before Completion and such updated disclosure letter shall become the Disclosure Letter for the purposes of this Agreement and making disclosures against the Warranties to be repeated at Completion. If any fact, matter or circumstances included in such updated Disclosure Letter would have otherwise entitled the Purchaser to make a Warranty Claim had it not been disclosed in the updated Disclosure Letter, the Purchaser shall have the right to cancel this Agreement pursuant to clause 15.13 at any time prior to Completion, but if it proceeds with Completion shall not be entitled to make a Warranty Claim in respect of such fact, matter or circumstance so disclosed.

16. Key Shareholders and Covenantors

16.1 **Key Shareholders' Warranties**

Subject to clause 17, in consideration of the Purchaser entering into this Agreement with the Vendor at the request of the Key Shareholders (as the Key Shareholders acknowledge by signing this Agreement), the Key Shareholders severally represent and warrant to the Purchaser in the terms of the Key Shareholders' Warranties in the knowledge that the Purchaser is entitled to rely on the truth of the statements contained in the Key Shareholders' Warranties.

16.2 **Key Shareholders' Warranties repeated**

Each of the Key Shareholders' Warranties is to be repeated on the Completion Date, by reference to the facts and circumstances and Vendor knowledge then existing.

16.3 **Period for Key Shareholder's Warranty Claim**

The Purchaser may not make any claim for breach of any Key Shareholders' Warranties after the end of the period twelve months following the Completion Date, except for the Key Shareholders' IP Warranties which shall survive until the second anniversary of the Completion Date.

16.4 **Limitations on claims**

The provisions of clauses 15.3, 15.4, 15.6 to 15.11 apply to the Key Shareholders' Warranties as if a reference to a Warranty were a reference to a Key Shareholder's Warranties and a reference to the Vendor was a reference to the Key Shareholders.

16.5 **Void payment**

If any payment made by or on behalf of the Vendor to the Purchaser is avoided by law, that payment will not be deemed to have discharged the liability of the Key Shareholders under this Agreement.

16.6 **Warranty**

Each Key Shareholder represents and warrants to the Purchaser that it has full power and authority to enter into and perform this Agreement, that this Agreement has been duly executed by that Key Shareholder and is a valid and binding document of that Key Shareholder.

16.7 **Undertaking**

Each of the Covenantors undertakes to:

(a) vote in favour (or procure any nominee shareholder of the applicable Covenantor to vote in favour) of all shareholder resolutions of the Vendor, and to procure that directors of the Vendor who are appointed by them vote in favour of all board resolutions required to satisfy the condition contained in paragraph (a) of Schedule 4 and any other approval required to implement the transaction evidenced in this Agreement; and

(b) use their reasonable endeavours to ensure that all approvals referred to in clause 16.7(a) are obtained as expediently as possible.

Each of the Covenantors hereby agrees and consents for the purposes of the Vendor's constitution (and all other purposes) to the Vendor entering into and performing the transactions contemplated by this Agreement.

16.8 **Rights cumulative**

The rights of the Purchaser under this clause 16 are cumulative and not exclusive of any rights provided by law and are to remain in full force until the discharge by the Covenantors of all of their respective obligations under this Agreement.

17. Liability of Key Shareholders

17.1 **Individual Liability of Key Shareholders**

Each of the Key Shareholders will, subject to clause 17.2 and 17.3, be severally liable in respect of any claim or liability which arises under this Agreement in respect of the Key Shareholders' Warranties or any other obligation of the Key Shareholders under this Agreement and notwithstanding any other provision of this Agreement the aggregate liability of each Key Shareholder for any and all claims and liabilities under this Agreement will not exceed an amount equal to the lesser of (i) the total amount of liability or damages settled or determined in respect of such claims multiplied by MPL for the relevant Key Shareholder as determined pursuant to clause 17.2 or (ii) the sum of all dividends and distributions (whether by way of share re-purchase or redemption or otherwise) paid or due by the Vendor to the relevant Key Shareholder (or to its nominee shareholder) after the Agreement Date and not otherwise repaid to the Vendor pursuant to any law and any then current Escrow Amount in respect of that relevant Key Shareholder, provided, however, that in the case of No8 Ventures Management Limited such aggregate liability shall be no less than US$1,500,000 and in the case of LINC Media, Inc. such aggregate liability shall be no less than US$900,000.

17.2 **Key Shareholder's Proportional Limitation of Liability**

Subject to clause 17.3, the total liability of the Key Shareholders pursuant to clause 17.1(i) in respect of any and all claims and liabilities will be applied proportionally as between the Key Shareholders such that each Key Shareholder's total maximum aggregate liability to the Purchaser in respect of any and all claims or liabilities arising under this Agreement will not exceed an amount determined by the following formula:

MPL = D/A

Where:

MPL = being the relevant Key Shareholder's proportion of liability to the Purchaser;

D = all dividends and distributions (whether by way of share re-purchase or redemption or otherwise) paid or due by the Vendor to the relevant Key Shareholder (or to its nominee shareholder) pursuant to the constitution of the Vendor as of the Agreement Date, which is attached to the Disclosure Material, after the Agreement Date;

A = the aggregate of D calculated in respect of both Key Shareholders

17.3 **Limitation on Purchaser's action**

(a) Where the Purchaser makes a Warranty Claim which has not been either settled or determined by the Earn Out Payment Date then the Purchaser shall first exhaust its rights to withhold an amount of Earn Out Amount before making a Warranty Claim against the Key Shareholders for a breach of any of the Key Shareholders Warranties.

(b) Where the Purchaser makes a Warranty Claim after the Earn Out Payment Date the Purchaser shall first exhaust its rights to withhold an amount of the Retention Amount before making a Warranty Claim against the Key Shareholders for a breach of any of the Key Shareholders Warranties. For avoidance of doubt, nothing in this clause 17.3(b) will limit the Purchaser from filing a Warranty Claim directly against the Key Shareholders for any amount that is greater than the Retention Amount.

(c) Subject to clauses 17.3(a) and (b), where the Purchaser makes a Warranty Claim against No 8 Ventures Management Limited for a breach of any of the Key Shareholders' Warranties, notwithstanding that the claim is brought against No 8 Ventures Management Limited, any damages settled or determined payable in relation to such claim are to be paid out of the Escrow Amount in accordance with clause 18 and the Escrow Deed. The Purchaser agrees that any Escrow Amount shall only be used to settle any liability of No 8 Ventures Management Limited to the Purchaser and it will not make a claim against the Vendor for release or payment of the Escrow Amount or a sum that was released from the Escrow Account to the Vendor and is due and payable to No 8 Ventures Nominees Limited as a dividend or distribution (whether by way of share re-purchase, redemption or otherwise).

17.4 **Notification**

(a) The Vendor and the Key Shareholders shall determine and pay or otherwise allocate the amount of all dividends and distributions due to the Key Shareholders pursuant to the constitution of the Vendor within 90 days of Completion.

(b) Within 90 days of Completion the Vendor and the Key Shareholders shall notify the Purchaser in writing of all dividends and distributions to be allocated, made or due by the Vendor to the Key Shareholders prior to the Earn Out Payment Date.

(c) Once an amount of dividend or distribution is calculated and allocated in respect of shares held by No 8 Ventures Management Limited the amount of that distribution or dividend to the extent it exceeds the Escrow Amount (the **Additional Escrow Amount**) shall not be paid to No 8 Ventures Management Limited but will instead be immediately paid by the Vendor to the Escrow Agent to hold as an additional part of the Escrow Amount in accordance with the Escrow Deed. Where any dividend or distribution is paid by the Vendor to a Key Shareholder both the Vendor and the Key Shareholder shall immediately give notice in writing to the Purchaser informing the Purchaser of the amount so paid.

18. Escrow Amount

18.1 **Amount and Payment to Escrow Agent**

(a) The Escrow Amount is to be paid by the Purchaser to the Escrow Agent on the Completion Date.

(b) The Additional Escrow Amount (if any) will be paid by the Vendor to the Escrow Agent on the date being not later than 90 days after the Completion Date.

(c) At Completion the Vendor, No 8 Ventures Management Limited, the Purchaser and the Escrow Agent shall enter into the Escrow Deed.

18.2 **Release of Escrow Amount**

The Escrow Amount or any proportion of the Escrow Amount (and any interest earned on that amount while it is held in escrow) will be released and paid by the Escrow Agent in the following manner:

(a) in the event of the Purchaser making a Warranty Claim against No 8 Ventures Management Limited in respect of any of the Key Shareholders' Warranties, and the amount of such Warranty Claim being agreed or settled by No 8 Ventures Management Limited and the Purchaser, the Escrow Agent shall, upon receiving written instructions from No 8 Ventures Management Limited and the Purchaser, pay to the Purchaser the lesser of:

(i) the Escrow Amount or;

(ii) a portion of the Escrow Amount equal to the amount of the agreed or settled Warranty Claim;

(b) at the end of the Escrow Period provided that no Warranty Claim has been made by the Purchaser against No 8 Ventures Management Limited in relation to a breach of any of the Key Shareholders' Warranties which remains outstanding, and provided that the Escrow Agent has not received any notice from the Purchaser stating that a Warranty Claim remains outstanding, the Escrow Agent must pay the balance of the Escrow Amount to the Vendor.

18.3 **Directions to Escrow Agent**

No 8 Ventures Management Limited and the Purchaser (who are also parties to the Escrow Deed) agree that they will act in good faith in relation to the release and payment of the Escrow Amount and that, unless there is a genuine dispute between them on bona fide grounds as to whether the requirements for the release of the amount to either No 8 Ventures Management Limited or the Purchaser have been met they will give directions to the Escrow Agent under the Escrow Deed to release and pay to No 8 Ventures Management Limited or the Purchaser (as applicable) the Escrow Amount, or the relevant proportion of the Escrow Amount in accordance with clause 18.2(a). Any dispute as to whether the requirements have been met shall be referred for determination in accordance with clause 18.4.

18.4 **Determination of Disputes**

If a matter in dispute is required to be referred for determination pursuant to clause 18.3 then:

(a) the matter in dispute must be referred to an appropriate independent expert agreed by No 8 Ventures Management Limited and the Purchaser or, in default of such agreement appointed by the President for the time being of the New Zealand Law Society which expert will be requested to

deliver its determination on the matter in dispute within 10 Business Days of being instructed to do so. Either No 8 Ventures Management Limited or the Purchaser may make the referral;

(b) that expert will review all relevant documents and information (including any submissions made by No 8 Ventures Management Limited or the Purchaser) and it will state in a signed decision its opinion regarding the matter in dispute;

(c) that determination:

(i) must be made by that person as an expert, and not as an arbitrator (and the Arbitration Act 1996 will not apply to the expert's consideration of the matter);

(ii) must be delivered within 10 Business Days of that expert receiving its instructions or as soon as practicable thereafter; and

(iii) will be final and binging on No 8 Ventures Management Limited and the Purchaser;

(d) No 8 Ventures Management Limited and the Purchaser will co-operate with each other to provide the expert with all information reasonably required by it to make its determination.

19. Expenses

Whether or not any of the transactions contemplated by this Agreement are completed, unless otherwise specified in this Agreement, each of the parties is to bear its own legal and accountancy costs and other expenses of and incidental to the preparation, execution and completion of this Agreement.

20. Delay

20.1 Time of essence

Time is of the essence in the performance by the parties of their obligations under this Agreement.

20.2 Exercise of rights and waivers

No delay, grant of time, release, compromise, forbearance (whether partial or otherwise) or other indulgence by one party in respect of any breach of any other party's obligations under this Agreement is to:

(a) **Operate as waiver**

operate as a waiver of or prevent the subsequent enforcement of that obligation; or

(b) **Not relevant for other breaches**

be deemed a delay, grant of time, release, compromise, forbearance (whether partial or otherwise) or other indulgence in respect of, or a waiver of, any subsequent or other breach.

No waiver by the Vendor or the Purchaser of its rights under this Agreement will be effective unless it is in writing and signed by the Vendor or the Purchaser (as the case may be).

21. Further assurances

(a) Each party must sign, execute and do all deeds, schedules, acts, documents and things as may reasonably be required by any other party effectively to carry out and give effect to the terms and intentions of this Agreement, whether before or after Completion.

(b) The Vendor will use reasonable endeavours to assist, following the Completion Date, the Purchaser in providing:

(i) any information required by the United States Securities and Exchange Commission within a reasonable period of time; and

(ii) any information, documentation or records reasonably required by the Purchaser to meet its reporting obligations under US GAAP.

(c) The Vendor will provide the Purchaser, within ten Business Days following the Completion Date:

(i) the Financial Statements; and

(ii) Management Accounts for the period commencing on 1 October 2007 and ending on the Completion Date.

22. Non merger

The obligations, warranties, undertakings and indemnities undertaken or given pursuant to this Agreement, to the extent not already performed at Completion, are not to merge on Completion, or on the execution or delivery of any document, pursuant to this Agreement, but are to remain enforceable to the fullest extent and notwithstanding any rule of law to the contrary.

23. Confidentiality and announcements

23.1 **Confidentiality**

Subject to clauses 23.2, 23.3 and 23.4, each of the parties agree to keep the terms of the Agreement and all other information exchanged by the parties in relation to the negotiation of this Agreement confidential and will ensure that each person who is at any time a Subsidiary of that party, and in the case of the Vendor and the LINC Media Inc, that Esphion Japan, also complies with this clause 23.1.

23.2 **Purchaser**

The Purchaser is entitled to make a public disclosure or release in respect of this Agreement and the transaction contained in this Agreement as the Purchaser deems required by the applicable laws, including securities laws of the United States of America or the rules of any stock exchange on which its shares are listed. Purchaser may disclose confidential information to its directors, officers, employees, agents, affiliates and professional advisers on a need to know basis.

23.3 **Vendor and Covenantors**

(a) The Vendor and the Covenantors must not, and will procure that their respective employees, officers, agents, Subsidiaries and Esphion Japan do not, without the prior written consent of the Purchaser make any disclosure, release or announcement regarding the content of this Agreement or details of the transaction contained in this Agreement.

(b) The Vendor and the Covenantors acknowledge that the Purchaser is a public company whose shares are traded on NASDAQ and any use or disclosure of non-public information relating to the Purchaser, this Agreement or the transaction contained in this Agreement is subject to the insider trading laws of the United States of America.

23.4 **Exceptions**

The obligations contained in clause 23.1 do not apply:

(a) **Fulfil the Conditions**

to the extent reasonably required by a party to fulfil the Conditions; or

(b) **Public domain**

to the extent that such information is already in the public domain; or

(c) **Related Companies**

to any disclosure of information by the Purchaser to any of its Related Companies; or

(d) **Disclosure to the New Zealand Venture Investment Fund**

any disclosure of general information which is non-price sensitive and non-technical information by the Vendor or the Covenantors or Key Shareholders to the New Zealand Venture Investment Fund or any similar investor in the Covenantors or Key Shareholders or investment funds managed by any of them in accordance with any existing agreement.

24. Entire agreement

This Agreement and any Agreed Form documents:

(a) **Entire understanding**

constitutes the entire understanding and agreement of the parties relating to the sale and purchase of the Assets and Business; and

(b) **Supersedes prior agreements**

supersedes and extinguishes all prior agreements and understandings between the parties relating to that sale and purchase including the term sheet for the purchase and acquisition of assets of Esphion Limited entered into by the Vendor, the Purchaser and the Covenantors dated 25 October 2007.

25. Amendments

This Agreement may only be amended in writing and as agreed by the parties.

26. Notices

26.1 **Form of notice**

Each notice or other communication under this Agreement is to be in writing, is to be made by facsimile, personal delivery or by post to the addressee at the facsimile number or address, and is to be marked for the attention of the person or office holder (if any), from time to time designated for the purpose by the addressee to the other parties. The initial facsimile number, address and relevant person or office holder of each party is set out under its name at the end of this Agreement.

26.2 **Notice effective**

No communication is to be effective until received. A communication is to, however, be deemed to be received by the addressee:

(a) **Facsimile**

in the case of a facsimile, on the second Business Day after it is sent, or if sent on a non-Business Day, on the third Business Day after the date of sending;

(b) **Personal delivery**

in the case of personal delivery, when delivered; and

(c) **Post**

in the case of a letter, on the seventh Business Day after posting by fast post or by airmail.

27. Assignment

27.1 **Successors**

This Agreement is to be binding on and will enure for the benefit of the parties and their respective successors and permitted assignees or transferees.

27.2 **Vendor and Covenantors**

Neither the Vendor nor a Covenantor may assign or transfer all or part of their respective obligations under this Agreement. The Vendor and the Covenantors acknowledge that the Purchaser may rely on the warranties and undertakings in this Agreement in giving warranties and undertakings to any subsequent purchaser of all or any of the Assets.

27.3 **Purchaser**

(a) Subject to clause 27.3(b), the Purchaser may assign or transfer its rights and obligations under this Agreement.

(b) Under the terms of the assignment referred to in clause 27.3(a), the assignee must agree specifically to be bound by the terms of this Agreement and to agree that for the purposes of the Earn Out Amount calculation, the relevant Net Revenues of both the Purchaser and the assignee shall be included. If any assignment or transfer of the Purchaser's rights or obligations under this Agreement is made during the Earn Out Period the Purchaser hereby guarantees the obligations of the assignee or transferee on the terms set out in clause 32. The Purchaser shall not be entitled to assign or transfer its obligations to hold or pay any monies to the Vendor under this Agreement after the Earn Out Period.

27.4 **Assignee**

Each assignee or transferee of the Purchaser is to have the same rights against the other parties to this Agreement as if named in this Agreement as Purchaser.

28. Counterparts

28.1 **Number of counterparts**

This Agreement may be executed in any number of counterparts each of which is to be deemed an original, but all of which together are to constitute one instrument.

28.2 **Any counterpart may be executed**

A party may enter into this Agreement by executing any counterpart.

28.3 **Facsimile or email exchange**

The parties acknowledge that this Agreement may be executed by an exchange of facsimile or email copies and execution of this Agreement by that means is valid and sufficient execution.

29. Governing law

29.1 **New Zealand law**

This Agreement is to be governed by and construed in accordance with the laws of New Zealand.

29.2 **Submission to exclusive jurisdiction**

Each of the parties irrevocably and unconditionally agrees that the New Zealand courts have the non-exclusive jurisdiction to hear and determine each suit, action or proceeding (**Proceedings**), and to settle disputes, which may arise out of or in connection with this Agreement and for those purposes irrevocably and unconditionally submits to the jurisdiction of the New Zealand courts.

29.3 **Service of proceedings**

The Purchaser hereby appoints Bell Gully (Attention: James Gibson, Partner) Solicitors at Level 22, Vero Centre, 48 Shortland Street, Auckland, New Zealand, facsimile +64 9 916 2201 to accept service or proceedings in New Zealand on its behalf.

30. No Set Off

Subject to clause 5.1, all sums payable to pursuant to this Agreement shall be paid free and clear of any restriction or condition and (except to the extent required by law) without any deduction or withholding on account of any Tax and without any deduction or withholding (except to the extent required by law) on account of any other amount whether by way of set off or otherwise.

31. Purchaser Warranties

31.1 The Purchaser warrants and represents:

(a) it will not contravene any law by entering into or performing its obligations under this Agreement;

(b) it has the power to enter into and perform its obligations under this Agreement and to carry out the transactions contemplated by this Agreement;

(c) it has taken all necessary action to authorise its entry into and performance of this Agreement and to carry out the transactions contemplated by this Agreement; and

(d) to the Purchaser's knowledge it has obtained all requisite Consents from any Public Authorities as may be necessary to allow it lawfully to complete the transactions contemplated by this Agreement.

32. Guarantee

32.1 **Guarantee**

From Completion the Purchaser irrevocably and unconditionally guarantees to the Vendor and will procure the due and punctual performance of each obligation of the Permitted Nominee contained in this Agreement and any of the Agreed Form documents. The Purchaser shall pay to the Vendor from time to time on demand any sum of money which the Permitted Nominee is at any time liable to pay to the Vendor under or pursuant to this Agreement and any of the Agreed Form documents and which have not been paid at the time the demand is made. The Purchaser's obligations under this clause are primary obligations and not those of a mere surety. If an obligation of the Permitted Nominee is void, voidable or unenforceable for any reason or if the Purchaser's obligation of the Permitted Nominee is void, voidable or unenforceable for any reason, the Purchaser's obligations under this clause are unaffected and the Purchaser shall perform the Permitted Nominee's obligations as if it were primarily liable for the performance and shall indemnify the Vendor against all costs, liabilities and expenses suffered or incurred by the Vendor in connection therewith.

32.2 **Continuing Obligations**

The Purchaser's obligations under clause 32.1 are continuing obligations and are not satisfied, discharged or affected by an intermediate payment or settlement of account by, or a change in the constitution or Control of, or the insolvency of, or bankruptcy, winding up or analogous proceedings relating to, the Permitted Nominee.

32.3 **Liability unaffected**

The Purchaser's liability under clause 32.1 is not affected by an arrangement which the Vendor may make with the Permitted Nominee or with another person which (but for clause 32.4) might operate to diminish or discharge the liability of or otherwise provide a defence to a surety.

32.4 **Actions of the Vendor**

Without affecting the generality of clause 32.3, the Vendor may at any time it thinks fit and without reference to the Purchaser:

(a) grant a time for payment or grant another indulgence or agree to an amendment, variation, waiver or release in respect of an obligation of the Permitted Nominee under this Agreement or any of the Agreed Form documents;

(b) give up, deal with, vary, exchange or abstain from perfecting or enforcing other securities or guarantees held by the Vendor;

(c) discharge a party to other securities or guarantees held by the Vendor and realise all or any of those securities or guarantees; and

(d) compound with, accept compositions from and make other arrangements with the Permitted Nominee or a person or persons liable on other securities or guarantees held or to be held by the Permitted Nominee.

32.5 **Bankruptcy**

The Purchaser's liability under clause 32.1 is not affected by the avoidance of an assurance, security or payment or a release, settlement or discharge which is given or made on the faith of an assurance, security or payment, in either case, under an enactment relating to bankruptcy or insolvency or other analogous event.

Execution

Allot Communications Limited by

/s/ Rami Hadar

CEO & President

Rami Hadar

Print Name

/s/ Doron Arazi

CFO

Doron Arazi

Print Name

Notice details for Allot Communications Limited

Address:	22 Hanager Street Neve Ne’eman Industrial Zone B Hod Hasharon 45240 Israel
Facsimile No:	+972 9 7603626
Contact Name:	Doron Faibish

Esphion Limited by

/s/ Mark Edwards

Director

Mark Edwards

Print Name

Notice details for Esphion Limited

Address:	Buddle Findlay Level 18 PricewaterhouseCoopers Tower 188 Quay Street Auckland New Zealand
Facsimile No:	+64 9 358 2055
Contact Name:	Grant Dunn

No. 8 Ventures Management Limited as manager of the **No 2 Fund & No 2/VIF Seed Fund** by:

/s/ Mark Edwards

Director

Mark Edwards

Print Name

Notice details for No 8 Ventures Management Limited

Address:	C/- PricewaterhouseCoopers 113-119 The Terrace Wellington
Facsimile No:	+64 9 375 3041
Contact Name:	Mark Edwards

LINC Media Inc. by

/s/ Terrie Lloyd

Director

Terrie Lloyd

Print Name

Notice details for LINC Media Inc.

Address: Odakyu Minami-Aoyama Building
10F, 7-8-1 Minami-Aoyama
Minato-ku
Tokyo 107-0062
Japan

Facsimile No: +81 3 3499 3109

Contact Name: Terrie Lloyd

TMT Ventures Limited by:

/s/ Ross George

Director

Ross George

Print Name

Notice details for TMT Ventures Limited

Address: C/- Direct Capital
Private Equity Limited
Level 6
2 Kitchner Street
Auckland

Facsimile No: +64 9 307 2349

Contact Name: Kory Fagan

K One W One Limited by

/s/ Brian Mayo Smith

Director

Brian Mayo Smith

Print Name

Notice details for K One W One Limited

Address: C/- BDO Spicers
Level 8
Westpac Tower
120 Albert Street
Auckland

Facsimile No: +64 9 303 2830

Contact Name: Damon Crowe

Schedule 1: Covenantors and Key Shareholders

Part A: Covenantors

No 8 Ventures Management Limited

LINC Media Inc.

TMT Ventures Limited

K One W One Limited

Part B: Key Shareholders

No 8 Ventures Management Limited as manager
of the No 2 Fund & No 2/VIF Seed Fund

LINC Media Inc.

Schedule 2: Assets

(a) the Goodwill;

(b) the Fixed Assets;

(c) the Leased Equipment;

(d) the Trade Debtors;

(e) the Intellectual Property Rights;

(f) the Business Records;

(g) the Stock; and

(h) the benefit of the Business Agreements (subject to the burden).

Schedule 3: Warranties

1. All information

1.1 **All information**

To the Vendor’s knowledge, all information contained in the Introduction to this Agreement, the Disclosure Letter, and the Disclosure Material (excluding the Financial Statements) (together the **Disclosure Information**) is, taken as a whole so that all relevant information on the Disclosure Information is taken into account with respect to the particular subject matter, materially accurate and materially complete and is not materially misleading in its context, in each case as at the date of the relevant information, and subject to any limitations or qualifications contained in the relevant information. The warranty contained in this paragraph does not apply to any information that is:

(a) a budget, forecast, estimate, projection, model, yield protection, price forecast or any other statement which relates to the future and any assumption, statement of opinion or statement of intent; or

(b) publicly available.

2. Material circumstances

2.1 **No insolvency action**

None of the following has occurred and is continuing, or to the Vendor’s knowledge is threatened, in relation to the Vendor:

(a) the appointment of a receiver of any Assets, liquidator or statutory manager;

(b) an application or order made, proceedings commenced, a resolution passed or proposed in a notice of meeting or other steps taken for:

(i) the liquidation, removal from the Companies Register, or statutory management of the Vendor; or

(ii) the Vendor entering into an arrangement with or assignment for the benefit of its creditors or a class of them;

(c) the Vendor:

(i) being (or taken to be under applicable legislation) unable to pay its debts, other than as the result of a failure to pay a debt or claim the subject of a good faith dispute; or

(ii) stopping or suspending, or threatening to stop or suspend, payment of all or a class of its debt; or

(d) the Vendor being unable to satisfy the solvency test set out in section 4 of the Companies Act 1993.

2.2 **No adverse effect**

Neither the execution of this Agreement, nor the transfer of the Assets and Business to the Purchaser pursuant to this Agreement, nor any other provision of this Agreement will:

(a) constitute a material breach of any obligation or any other breach which gives rise to termination of the Agreement to which the Vendor is a party; or

(b) entitle any person to cancel, terminate earlier than would otherwise have been the case, or adversely modify any contract, agreement or arrangement to which the Vendor is a party or under which the Vendor is entitled to a material right or material benefit, or any material provision thereof; or

(c) entitle any person to acquire, or to require the Vendor to dispose of, any material right or material benefit relating to the Business or any of the Assets to which the Vendor is entitled, or any material interest therein; or

(d) to the Vendor's knowledge, be likely to cause any supplier or customer of the Business to discontinue or substantially reduce its trade with or patronage of the Business; or

(e) to the Vendor's knowledge, otherwise cause or be likely to cause any material right or material benefit of or pertaining to any Asset to be cancelled, terminated or lost or adversely qualified or impaired, except as a result of any unlawful act or omission by any third party,

2.3 **Authority**

The Vendor has full power and authority to enter into and, subject to approval by the shareholders of the Vendor pursuant to section 129 of the Companies Act 1993 and compliance with various class rights set out in the Constitution, perform this Agreement.

2.4 **Product Warranties**

As at the Completion Date, there will be or are no Product Warranties.

3. Financial matters

3.1 **Accuracy of the Financial Statements**

The Financial Statements:

(a) have been prepared under NZ GAAP, and contain no qualifications made by the independent auditors;

(b) show a true and fair view of the assets and liabilities and the state of affairs, financial position and results of the Vendor as at the balance dates shown in the Financial Statements and the financial performance of the Vendor for the periods ending on the balance date.

3.2 **Financial books and records**

The books and records of the Business accurately set out and disclose in all material respects the financial condition of the Business. All financial transactions of the Vendor concerning the Business have been accurately recorded in all material respects in such books and records.

3.3 **Management Accounts**

The Management Accounts accurately disclose in all material respects the financial condition of the Business. Such Management Accounts:

(a) accurately reflect in all material respects the basis for the financial condition and the revenues, expenses and results of operations of the Business shown therein; and

(b) present fairly in all material respects the financial condition and the revenues, expenses, results of the operations and financial performance of the Business.

3.4 **No revaluation**

Since the Balance Date there has been no revaluation of any Asset.

4. Operation of the Business since Balance Date

4.1 **Operations**

From the Balance Date the Vendor has:

(a) operated and conducted the Business in the ordinary course;

(b) not acquired or disposed of any of the Assets other than in the ordinary course of business;

(c) not entered into any agreement except for agreements in the ordinary course of business;

(d) not incurred any liabilities other than in the ordinary course of business.

4.2 **State of the Business**

To the Vendor's knowledge and in the Vendor's opinion, since the Balance Date there has not been a Material Adverse Event.

5. Assets

5.1 **No Encumbrances**

The Vendor has legal and beneficial title to all of the Assets, free and clear from Encumbrances. The Vendor has not created, or agreed to create, any Encumbrance in respect of any of its Assets.

5.2 **No other assets required**

The Assets comprise all the assets, both tangible and intangible, owned by and used by the Vendor in or concerning the Business.

5.3 **No other interest**

No person other than the Vendor is entitled to possession of, or any interest in, any of the Assets of the Business.

5.4 **Condition**

To the Vendor's knowledge, all material tangible assets of the Business are in a state of operation condition and repair and condition suitable for the purposes for which they are being used at the Agreement Date, fair wear and tear excepted.

6. Intellectual property and Information Technology

6.1 **Ownership of Intellectual Property Rights**

(a) The Vendor solely owns and has good, valid, subsisting and enforceable title to, free and clear of any Encumbrances, all Intellectual Property Rights.

(b) The Business does not require (as currently conducted) any Intellectual Property Rights or Intellectual Property licence other than the Intellectual Property Rights and the Intellectual Property Licence In.

6.2 **Software**

Appendix 5 contains a complete list of all computer software owned (including computer software currently being developed) by the Vendor (the **Vendor's Software**). There is no one other than the Vendor that has any Encumbrance on any of the Vendor's Software other than third party rights in respect of any Open Source Component.

6.3 **Registered Intellectual Property Rights**

Schedule 6 contains a complete list of all registered (or applications for registration) Intellectual Property Rights owned by the Vendor or in which the Vendor has any interest (**Registered Intellectual Property**). The Vendor is recorded on the relevant register as the sole registered proprietor or applicant (as the case may be) of the Registered Intellectual Property.

6.4 **Patents**

(a) To the Vendor's knowledge (without making any independent patent search), there is no prior art or any other possible claim which renders the inventions of the Vendor referred to in the patents or patent applications listed in Schedule 6 invalid in any manner.

(b) The Vendor is not aware of any misrepresentation to, and has not intentionally or wilfully concealed any relevant or material fact from, any patent office or registry agency, during prosecution of any of the patents or patent applications listed in Schedule 6.

(c) The Vendor is not aware of any fact which would preclude the grant of issued patent registrations based on its patent applications.

6.5 **Trade Marks**

(a) The Vendor is the sole owner of the Trade Marks.

(b) To the Vendor's knowledge, the Vendor has complied in all material respects with the requirements of, and has filed all material documentation required in dealing with, the US Patent and Trademark Office and any other trademarks and domain name registry agencies in which its Trademarks were filed.

(c) All of the Trademarks are in effect, and to the Vendor's knowledge, the Vendor has taken such steps as are required, including payment of the necessary maintenance fees, to maintain the enforceability of the Trade Marks and trade marks applications.

6.6 **Infringement and third party rights**

(a) To the Vendor's knowledge no Intellectual Property Rights have infringed or infringe upon, or are a misuse of any intellectual property rights of any third party.

(b) No Intellectual Property Rights are subject to any outstanding injunction, judgment, order, decree, or charge. No action, suit, claim or governmental proceeding, hearing, investigation (to the Vendor's knowledge), complaint, or demand has been made or to the Vendor's knowledge is pending or threatened, which challenges the legality, validity, scope, enforceability, use, or ownership of any of the Intellectual Property Rights (whether registered or unregistered), and the Vendor was not served with any notice relating to the intention of any party to commence such actions.

(c) The Vendor has not received:

(i) correspondence indicating any challenge, assertion or claim regarding the use of, or challenging or questioning the Vendor's right or title in, any of the Intellectual Property Rights; and/or

(ii) communications alleging that the Vendor has violated, would violate, any of the patents, trade marks, service marks, trade names, copyrights or trade secrets or other proprietary rights of any other person or entity, nor, to the Vendor's knowledge, is there any basis for any such communication.

(d) To the Vendor's knowledge, no person has the right to assert any claim regarding the use of, or challenging or questioning the Vendor's right or title in, any of the Intellectual Property Rights and the Vendor is not aware of any potential basis for such an allegation or of any specific reason to believe that such an allegation may be forthcoming.

6.7 **Employees and Consultants**

(a) Any and all of the Intellectual Property Rights have been developed or is currently being developed, by employees, consultants or other agents of the Vendor. All of the Intellectual Property Rights have been properly assigned conveyed and transferred in their entirety to the Vendor by its inventors.

(b) No founder, employee, director, consultant or shareholder of the Vendor or former employer of any such founder, employee, director, consultant or shareholder has any rights to any Intellectual Property Rights.

(c) Each of Vendor's employees, and to the Vendor's knowledge, each of the consultants or other agents have entered into written agreements with the Vendor assigning to the Vendor all rights in the Intellectual Property Rights developed in the course of their employment by, or provision of services to, the Vendor and each of the Vendor's employees and other persons who, either alone or in concert with others, developed, invented, discovered, derived, programmed or designed the Intellectual Property Rights, have entered into a written agreement with the Vendor (the **IP Assignment and Non-Confidentiality Agreements**). To the Vendor's knowledge, the IP Assignment and Non Confidentiality Agreements are valid and binding agreements of the parties thereto, enforceable in accordance with its terms; and the Vendor thereby has obtained ownership of, and is the exclusive owner of such work, material or invention by operation of law or by valid assignment, to the fullest extent legally possible.

(d) To the Vendor's knowledge, it is not and will not be necessary to utilize any inventions, trade secrets or proprietary information of any of its employees made prior to their employment by the Vendor, except for inventions, trade secrets or proprietary information that have been duly and properly assigned to the Vendor.

(e) To the Vendor's knowledge no employee of the Vendor breached any third party contract with respect to any item of the Intellectual Property Rights.

6.8 **Licences**

(a) The Disclosure Material identifies each material item of Intellectual Property Licence In that the Business uses. The Disclosure Material contains correct and complete copies of all such Intellectual Property Licences In. To the Vendor's knowledge, the material Intellectual Property Licences In are legal, valid, and enforceable and the Vendor is not aware of any reason why they should not remain on identical terms following Completion.

(b) The Vendor has taken all reasonable security measures, including measures against unauthorized disclosure, to protect the secrecy, confidentiality and value of its trade secrets and other Intellectual Property Rights, which measures are reasonable and customary in the industry in which the Vendor operates.

(c) Other than as part of a licence granted to the Vendor's customers and/or distributors which is required in order to utilise the Vendor's Products, the Vendor has not transferred ownership of, or granted any licence with respect to, any Intellectual Property Rights to any third party. The Disclosure Material contains a true, correct and complete list of all licences or agreements that grant to a third party the right to use the Intellectual Property Rights, other than licences or agreements relating to off-the-shelf software products.

(d) To the Vendor's knowledge, the Vendor has not agreed to indemnify other than in the ordinary course of business, any person for or against any interference, infringement, misappropriation, or other conflict with respect to any of the Intellectual Property Rights. The Vendor is not under any obligation to pay any royalty or other compensation to any third party or to obtain any approval or consent from any third party for the use of any Intellectual Property Rights.

6.9 **Disclosure**

(a) To the Vendor's knowledge, there is no unauthorised use, disclosure, infringement or misappropriation of any Intellectual Property Rights (including source code) by any third party, including, without limitation, any employee, consultant, or former employee or consultant of the Vendor.

(b) To the Vendor's knowledge, the Vendor has not incorporated in its products or services, has not based them upon or derived them from or adapted them from, any proprietary information of any other person in violation of any statutory or other legal obligation or any agreement to which the

Vendor is a party or by which it is bound.

6.10 **Open Source**

Other than as set out in Appendix 6, the Intellectual Property Rights do not include any open source, shareware, freeware code or other freely available software (Open Source Component) that is subject to restrictions on use. The Disclosure Material includes a list of all software or other material that is or is required to be distributed as "freeware," "free software," "open source software" or under a similar licensing or distribution model that the Vendor uses or licenses, and identifies that which is incorporated into, combined with, or distributed. The Vendor's use and distribution of each such component, and the contemplated use thereof in conjunction with the Vendor's Products, complies with all material provisions of the applicable license agreement, and in no case does such use or distribution give rise under such license agreement to any material obligations of the Vendor with respect to any Intellectual Property Rights, including without limitation any obligation to disclose or distribute any such Intellectual Property Rights in source code form, to license any such Intellectual Property Rights for the purpose of making derivative works, or to distribute any such Intellectual Property Rights without charge.

6.11 **Bugs and Viruses**

(a) None of the Vendor's Software and any other software used, marketed, distributed, licensed, or sold by the Vendor (including any software that is part of, is distributed with, or is used in the design, development, manufacturing, production, distribution, testing, maintenance, or support of any Vendor Software, but excluding any third-party software that is generally available on standard commercial terms and is licensed to the Vendor solely for internal use on a non-exclusive basis):

(i) To the Vendor's knowledge, contains any bug, defect, or error (including any bug, defect, or error relating to or resulting from the display, manipulation, processing, storage, transmission, or use of date data) that materially and adversely affects the use, functionality, or performance of such Vendor Software or any product or system containing or used in conjunction with such Vendor Software; or

(ii) To the Vendor's knowledge, fails to comply with any applicable warranty or other contractual commitment relating to the use, functionality, or performance of such Vendor Software or the Disclosure Material contains a complete and accurate list of all known bugs, defects, and errors in each version of the Vendor Software.

(b) To the Vendor's knowledge, no Vendor Software contains any "back door," "drop dead device," "time bomb," "Trojan horse," "virus," or "worm" (as such terms are commonly understood in the software industry) or any other code designed or intended to have, or capable of performing, any of the following functions:

(i) disrupting, disabling, harming, or otherwise impeding in any manner the operation of, or providing unauthorized access to, a computer system or network or other device on which such code is stored or installed; or

(ii) damaging or destroying any data or file without the user's consent.

6.12 **Deposit in Escrow**

No source code for any Vendor Software has been for the 3 years prior to the Completion Date delivered, licensed, or made available to any escrow agent or other person who is not, as of the date of this Agreement, an employee of the Vendor. The Vendor has no duty or obligation (whether present, contingent, or otherwise) to deliver, license, or make available the source code for any Vendor Software to any escrow agent or other person.

6.13 **Esphion Japan Intellectual Property**

No intellectual property has been created through the activities, operations or existence of Esphion Japan in respect of which the Vendor has any interest.

6.14 **FRST Grant**

The New Zealand Government acting through the Foundation for Research, Science and Technology (**FRST**) has no claims, nor any right to make any claims, in relation to any royalties or payments resulting from the sale of the product developed by the Vendor in connection with the grant provided by FRST under the Technology New Zealand Contract for Technology for Business Growth dated 27 February 2004 between FRST and the Vendor.

6.15 **Name protection**

The Vendor has not consented to the adoption of a similar name by another person, nor granted any licence of or any right to use (other than in respect of Esphion Japan and a Group Company), the name of the Vendor or any word or words forming part of the name of the Vendor.

7. Material commitments

7.1 **Warranties and defective products**

(a) To the Vendor's knowledge, the Vendor has not sold or supplied products or provided services which are faulty or defective and which may result in claims against the Vendor after the Completion Date. There are no current claims against the Vendor for faulty or defective products or services provided by the Vendor.

(b) To the Vendor's knowledge, there are no representatives or warranties which have been given by the Vendor in respect of any products supplied or services provided by the Vendor under which a claim may be made against the Vendor after the Completion Date.

7.2 **Trading agreements and outstanding offers**

(a) To the Vendor’s knowledge, the Vendor, in respect of the Business, has observed and performed all the material terms and conditions on its part to be observed and performed under its contractual agreements, and similar obligations and is not in material default under or material breach of any such agreement or obligation; and

(b) The Vendor acknowledges, that except as disclosed in the Disclosure Materials, it has not made any promises, guarantees, warranties or representations, written or oral, to provide customers with any services, products, including, updates, upgrades and/or customizations to such products, where such obligation is, or will become through the passage of time, enforceable following the Completion Date on the Vendor.

7.3 **Material commitments**

To the Vendor’s knowledge, the Vendor is not a party, in respect of the Business, to any material agreement which:

(a) is outside the ordinary course of business;

(b) is incapable of performance under its terms within a reasonable time;

(c) involves the supply of goods or services, the aggregate sales value of which will represent in excess of 30 per cent of the turnover expected for the current financial year of the Business;

(d) involves the Vendor giving a guarantee or indemnity in respect of, or to be otherwise contingently liable for, the obligations of, any other person;

(e) is with any Related Company of the Vendor (other than with LINC Media Inc. or Esphion Japan);

(f) restricts or prevents the Vendor from carrying on or its ability to engage in any activity or business in any area; or

(g) confers on any person any material rights as a consequence of a change in ownership of the Business.

8. Property

8.1 **Only property**

The Leasehold Property comprises the only land and buildings occupied by the Business.

8.2 **No breach**

To the Vendor’s knowledge, the Vendor is not in breach of any material agreement concerning, or of any material obligation affecting, the Leasehold Property.

8.3 **No third party right**

To the Vendor’s knowledge no material rights, easements, quasi-easements or privileges exist in favour of any person in respect of the part Leasehold Property.

8.4 **Enforcement action**

To the Vendor’s knowledge, there are no outstanding enforcement or other notices, requisitions, requirements or proceedings issued or to the Vendor’s knowledge threatened, in respect of the Leasehold Property by any Public Authority, landlord, tenant or other person which are materially adverse to the Business.

9. Compliance with laws

9.1 **Compliance**

To the Vendor’s knowledge, there are no applicable material requirements of any statute, regulation, regulatory authority or territorial authority with which the Vendor has not complied fully and in a timely manner for the last 24 months.

9.2 **All Consents held**

To the Vendor’s knowledge, the Vendor has all Consents which are required or are necessary for the carrying on of the Business.

10. Legal proceedings

10.1 **No cause of action**

To the Vendor’s knowledge, there is not any cause of action relating to the Business or the Assets which could or might be used to commence legal proceedings, either civil or criminal.

10.2 **No proceedings**

The Vendor is not and has not in the last two years been:

(a) a party to any legal action or proceedings or other form of formal mediation or formal dispute resolution (other than as plaintiff in normal debt collection matters or as a party to a personal grievance bought by an employee); or

(b) to the Vendor’s knowledge, subject to any investigation by any Public Authority.

10.3 **No unsatisfied judgments**

There are no unsatisfied judgments, court orders or awards outstanding against the Vendor.

10.4 **Product or service claims**

To the Vendor’s knowledge, there are no product or service warranty claims against the Vendor in respect of products supplied by the Vendor and to the Vendor’s knowledge, no circumstances exist that will give rise to any such claims.

11. Statutory records

11.1 **All records kept**

The Vendor holds all accounting and other records relating to the Business which are required to operate the Business and such records are properly and fully maintained in all material respects.

11.2 **Documents of title**

All documents of title, or documents which otherwise evidence title, to the Assets are in the Vendor’s possession or under the control of the Vendor.

12. Employees

12.1 **Full disclosure**

The Vendor has provided to the Purchaser the following details of the Existing Employees:

(a) all of the terms and conditions of the employment;

(b) all benefits provided (including discretionary benefits);

(c) details of all applicable redundancy policies;

(d) details of length of service; and

(e) accrued entitlements to leave (including, without limitation, annual leave, sick leave and long service leave).

12.2 **No union agreements**

The Vendor is not a party to any agreement with any union, collective bargaining agent or industrial organisation in respect of any Existing Employee.

12.3 **No termination benefits**

There is no agreement or liability to pay a termination benefit to any Existing Employee of the Business other than accrued leave entitlements.

12.4 **No disputes with employees**

The Vendor is not involved in any personal grievance, wrongful dismissal claim, dispute or any other claim with any Existing Employee, or former employees or any person or organisation representing any such employee. To the Vendor’s knowledge, no event has occurred which might give rise to such a claim.

12.5 **Health and safety**

To the Vendor’s knowledge, the Vendor is not subject to any health and safety investigation by any Public Authority and no event has occurred which might give rise to any audit, prosecution, investigation or claim related to health or safety.

13. Superannuation

There is no claim for, nor is the Vendor under any legal liability to pay, any pension, retirement, death, disability, or medical aid payment, employee insurance premium or any other similar payment to any past or present director, employee or contractor of the Vendor or any of their families or dependants and no such pension or payment is now being paid voluntarily.

14. Investments

The Vendor is not a party to any joint venture, partnership, syndicate, consortium, or other body or association, whether incorporated or not (other than a recognised trade association and in respect of Esphion Japan).

15. Due execution

The Vendor:

(a) if a company, is validly existing under the laws of its place of incorporation;

(b) subject to obtaining the necessary shareholder consents has the power to enter into and perform its obligations under this Agreement and to carry

out the transactions contemplated by this Agreement;

(c) subject to obtaining the necessary shareholder consents has taken all necessary action to authorise its entry into and performance of this Agreement and to carry out the transactions contemplated by this Agreement;

(d) subject to obtaining the necessary shareholder consents, obligations under this Agreement are valid and binding and enforceable against it in accordance with their terms; and

(e) has, to the Vendor's knowledge, obtained all requisite Consents from any Public Authorities as may be necessary to allow it lawfully to complete the transactions contemplated by this Agreement.

Schedule 4: Conditions

Completion of this Agreement is subject to the satisfaction of the following conditions precedent:

	Condition Precedent	Condition Satisfaction Date	Party for whose benefit Condition has been inserted
	(a) **Vendor's Approvals** The Vendor securing the approval of its shareholders to the transactions contemplated by or otherwise arising as a consequence of this Agreement, including all approvals required under the Vendor's constitution and all approvals required by law including under section 129 of the Companies Act).	Completion Date	Vendor and Purchaser
	(b) **Existing Employees Retention** Each Existing Employee entering into a new employment agreement with the Purchaser on terms no less favourable than their existing employment contract with the Vendor.	Completion Date	Purchaser

Appendix 7: Confidentiality Agreement

Confidentiality Deed

Allot Communications Limited

Provider

and

Esphion Limited

Recipient

Date

This **Confidentiality Deed** is made on

between (1) **Allot Communications Limited (Provider)**

and (2) **Esphion Limited (Recipient)**

Introduction

A. The Recipient and the Purchaser have entered into a sale and purchase agreement for the business and the assets of Esphion Limited dated 1 January 2008 (**Sale and Purchase Agreement**). The Sale and Purchase Agreement provides that on the date specified in the agreement an earn out payment is to be

made from the Provider to the Recipient (subject to certain conditions). The amount of the earn out payment (the **Earn Out Amount**) is to be calculated by the Provider and delivered to the Recipient. The Recipient can then either agree or disagree with this calculation. The Purchaser is to give the Recipient access to all additional information it may require to enable the Recipient to make its decision to agree or disagree with the calculation of the Earn Out Amount.

B. The Recipient wishes to receive the additional information referred to above for the purpose of deciding whether to agree or disagree with the calculation of the Earn Out Amount. The Provider has agreed to provide information to the Recipient for the sole purpose of enabling the Recipient to make its decision whether to agree or disagree with the calculation of the Earn Out Amount.

C. The information to be provided is of a confidential nature and is of commercial value to the Provider. In order to protect and maintain the confidentiality and value of such information, the Recipient has agreed to enter into this Deed.

It is agreed

1. Interpretation

1.1 Definitions

In this Deed, unless the context otherwise requires:

Information means:

(a) all oral and written information (including, without limitation, all business and financial information, opinions, projections and other statements which relate to the calculation of the Earn Out Amount) and records (in whatever form) relating to the business or affairs of the Provider or any of its Related Companies made available to or for the benefit of the Recipient (including to any of the Recipient’s advisers) by or on behalf of the Provider or any of its Related Companies (including by any of the Provider’s advisers);

(b) all notes, memoranda and records (in whatever form) of the Recipient or any of its officers, employees or advisers containing, referring to or based upon any information supplied to the Recipient (including to any of the Recipient’s advisers) by or on behalf of the Provider; and

(c) all rights relating to any of the information set out in paragraphs (a) and (b) above.

Related Company in relation to a company has the meaning given to that expression in section 2(3) of the Companies Act 1993 provided that, for this purpose, references to “company” in that section shall extend to any body corporate wherever incorporated or registered.

Sale and Purchase Agreement means the agreement relating to the sale and purchase of the Business and Assets of Esphion Limited between the Provider, the Recipient, the Covenantors and the Key Shareholders (as defined in that agreement) dated 1 January 2008.

1.2 General references

In this Deed, unless the context otherwise requires:

(a) a reference to a clause or schedule is a reference to a clause or schedule of this Deed;

(b) a reference to this Deed or another instrument includes any variation, novation or replacement of either of them;

(c) the singular includes the plural and vice versa;

(d) the word person includes an individual, a body corporate, an association of persons (whether corporate or not), a trust, a state or an agency of state, government departments and local and municipal authorities in each case, whether or not having a separate legal personality; and

(e) words importing one gender include the other genders.

1.3 Headings

Headings are to be ignored in construing this Deed.

2. Information property of the Provider

2.1 The Information is, as between the Provider and the Recipient, the absolute property of the Provider and its Related Companies. Subject to the provisions of this Deed, all Information remains the absolute property of the Provider and its Related Companies.

2.2 The Information contains information of a confidential nature which is of commercial value to the Provider and its Related Companies. Loss or damage would be sustained by the Provider and its Related Companies if the Information should:

(a) come into the possession of an unauthorised person; or

(b) be used in any way by any person in competition with the Provider or any of its Related Companies.

3. Confidentiality undertakings

3.1 Maintain confidential

The Recipient:

(a) must receive the Information in the strictest confidence and in good faith; and

(b) must maintain the confidentiality of the Information by the Recipient and the persons referred to in clause 5.

3.2 Prohibitions

Except in accordance with this Deed, or with the prior written consent of the Provider, the Recipient must not:

(f) No disclosure

directly or indirectly disclose or distribute the Information or permit the Information to be disclosed or distributed to any unauthorised person (including any agent, adviser or shareholder of or to the Recipient or any of its Related Companies) except as provided in clause 5; or

(g) No use

use the Information or any knowledge which it may acquire as a result of receiving the Information in any way which furthers competition with the Provider or any of its Related Companies or which is otherwise directly or indirectly detrimental to the interests of the Provider or any of its Related Companies or for any purpose other than deciding whether to agree with the calculation of the Earn Out Amount; or

(h) No assertion of ownership

assert rights of any nature in respect of, or contest the Provider's or the Provider's Related Companies' ownership of, the Information; or

(i) Reproduce

reproduce in any way, or permit to be reproduced in any way, the Information, for any purpose other than deciding whether to agree with the calculation of the Earn Out Amount; or

(j) Competitors

in particular, and without limiting any of the other obligations of the Recipient set out in this clause 3.2, give, disclose or distribute the Information or permit the Information to be given, disclosed or distributed to any person who competes with the Provider or any Related Company of the Provider.

3.3 Excluded Information

The following Information is not subject to the restrictions of this Deed:

(a) Information which is clearly and demonstrably approved in writing by the Provider for disclosure (other than on a restricted basis) by the Recipient prior to such disclosure;

(b) Information independently acquired or developed by the Recipient without the benefit or use of any of the Information and the same can be evidenced in writing;

(c) Information publicly known or which becomes publicly known after the date of this Deed other than through breach or non-performance by the Recipient (or any of the persons referred to in clause 5) of any of its or their obligations under this Deed or as a result of any of the persons referred to in clause 5 failing to observe the confidentiality obligations set out in this Deed; and

(d) Information lawfully received by the Recipient from a third party not owing (directly or indirectly) any obligation of confidentiality to the Provider or any of its Related Companies.

4. No reliance on Information

The Information is provided to the Recipient for its benefit solely for the purpose of assisting the Recipient to decide whether to agree with the calculation of the Earn Out Amount on the following terms:

(a) the Recipient is solely responsible for its own assessment and evaluation of the Information;

(b) no responsibility is accepted for, and no person is authorised to make, any other representations or warranties on behalf of the Provider or any of its Related Companies.

5. Disclosure of information to third parties

5.1 Recipient's officers, employees and advisers

Notwithstanding the provisions of this Deed, the Recipient may disclose the Information to such of its advisers and shareholders only to the extent necessary to enable such persons to evaluate the Information for the sole purpose of deciding whether to agree with the calculation of the Earn Out Amount. Prior to and as a condition of the Recipient disclosing the Information to any such persons, the Recipient must provide to the Provider a signed confidentiality undertaking from each such person in the form attached as a Schedule to this Deed.

5.2 Recipient must ensure compliance by third parties

The Recipient must ensure that all persons to whom the Information is disclosed under clause 5.1 are aware of the confidentiality of the Information, the existence and terms of this Deed, and consider themselves bound by the provisions of this Deed as if they were parties to it. The Recipient must take all such steps as are reasonably necessary to prevent any unauthorised use or disclosure of the Information by any such person. The Recipient agrees to be

responsible for any act or omission of such person constituting a breach of this Deed or which would constitute a breach of this Deed if done or omitted by the Recipient and to bear all damages caused to the Provider as a result of a breach by such persons, in accordance with clause 7.1.

6. Return, destruction and erasure of information

6.1 The Recipient must, on receipt of a written request by the Provider:

(a) return to the Provider; and/or

(b) destroy or if technically practicable, erase,

all the Information (including all reproductions of Information) in the possession or control of the Recipient or its officers, employees and advisers to whom the Information has been disclosed, together with all information and documentation containing, comprising or relating in any way to the Information and procure that each person who has received Information under clause 5 does the same provided that any adviser who is compelled by law or regulation or the terms of any professional indemnity insurance policy may retain a copy of all such Information and documentation.

6.2 Upon the return, destruction or erasure of all Information in accordance with clause 6.1, the Recipient must provide a certificate to this effect signed by a director or other authorised senior officer of the Recipient.

6.3 The return, destruction or erasure of the Information in accordance with clause 6.1 does not release the Recipient or its officers, employees and advisers from their obligations under this Deed.

7. Indemnity

7.1 Indemnity for unauthorised disclosure or use

The Recipient indemnifies the Provider and each of its Related Companies from and against all actions, claims, costs, demands, expenses, liabilities, losses, payments and proceedings actually and reasonably incurred or suffered by them (other than in respect of any action, claim or proceedings by the Vendor or its shareholders against the Purchaser for breach of the Sale and Purchase Agreement) which arise, directly or indirectly, from the unauthorised disclosure or use (whether intentional or unintentional) of the Information by the Recipient or by any of its Related Companies or any of its or their respective officers, employees or advisers or which arise from any of such persons being in breach of any of the provisions of this Deed. The Provider will take all reasonable steps to mitigate any such claims, costs, expenses, liabilities or losses.

7.2 Ability to seek equitable relief

If there is a breach of the terms of this Deed by the Recipient or by any person to whom the Recipient has made any of the Information available, the Provider and each of its Related Companies are entitled to seek equitable relief in addition to damages. In any proceeding bought by the Provider or its Related Companies against the Recipient seeking equitable relief for a breach of this Deed, neither the Recipient nor any person directly or indirectly under its direction or control may claim that the breach is one which may not be the subject of equitable relief.

8. Compulsory disclosure

If the Recipient is required or requested by any court, governmental or regulatory agency to disclose any Information, the Recipient will immediately advise the Provider of that requirement or request and will co-operate with the Provider in opposing the requirement or request, if the Provider so requires and if feasible under the laws and regulations of the jurisdiction in which the Recipient operates. In any event, the Recipient agrees to comply with all reasonable directions of the Provider to disclose only that part of the Information which the Recipient is legally required to disclose, and to use reasonable efforts to obtain an assurance that the Information disclosed will be treated confidentially. The Provider will pay any costs reasonably and properly incurred by the Recipient in complying with its obligations under this clause.

9. Dealing in securities and price sensitive information

The Recipient acknowledges that Provider’s ordinary shares are publicly traded in the United States and understands that the Information may constitute material non-public information under applicable United States securities laws. The Recipient agrees to take reasonable steps to inform its representatives who receive Information of the Provider of this fact and to prevent them from trading in the Provider’s ordinary shares for so long as any Information includes material non-public information regarding the Provider.

10. General

10.1 Obligations to continue

The obligations in this Deed continue to apply for a period of five years from the date hereof.

10.2 Execution of further documents

The Recipient must take such actions and execute, or procure the execution of, such documents as the Provider may reasonably request to give full effect to this Deed.

10.3 Waivers in writing

No waiver by either party or any of its Related Companies of any provision of or right, remedy or power of such party or any of its Related Companies under this Deed, and no amendment to this Deed, is to be effective unless it is in writing signed by the parties and any such waiver is to be effective only in the specific instance and for the specific purpose for which it is given. No failure or delay by either party or any of its Related Companies to exercise any right, remedy or power under this Deed or to insist on strict compliance by the other party with any obligation under this Deed, and no custom or practice of the parties at variance with the terms of this Deed, will constitute a waiver of the right of such party or any of its related companies to demand exact compliance with this Deed.

10.4 Contracts (Privity) Act

For the purposes of the Contracts (Privity) Act 1982, where the covenants of either party contained in this Deed are given for the benefit of any third party such covenants are intended to be enforceable against the other party by such third party.

10.5 Severability

If any provision of this Deed is, or becomes, unenforceable, illegal or invalid for any reason, the relevant provision is to be deemed to be modified to the extent necessary to remedy such unenforceability, illegality or invalidity or if this is not possible then such provision must be severed from this Deed, without affecting the enforceability, legality or validity of any other provision of this Deed.

10.6 Governing law and jurisdiction

This Deed is to be construed in accordance with the laws of New Zealand and the parties submit to the non-exclusive jurisdiction of the courts of New Zealand in relation to this Deed.

10.7 Counterparts

This Deed may be signed and delivered (including by way of electronic transmission) in any number of counterparts all of which, when taken together, shall constitute one and the same instrument. A party may enter into this Deed by executing any counterpart.

Execution

Executed as a Deed.

Recipient by

____________________	____________________
Director	Director
____________________	____________________
Print Name	Print Name

SCHEDULE
Form of Undertaking

DEED dated

Full Name, Address and Occupation of Recipient

____
____ **(Recipient)**

Introduction

A. Allot Communications Limited (**Provider**) and Esphion Limited (**Principal Recipient**) have entered into a Confidentiality Deed dated (**Confidentiality Deed**) relating to the provision of certain Information (as that term is defined in the Confidentiality Deed) by the Provider to the Principal Recipient.

B. The Provider has agreed that the Principal Recipient may provide the Information to the Recipient on the condition that the Recipient enters into this Deed so as to ensure that the confidential nature and commercial value of the Information is preserved.

Covenants

1. The Recipient acknowledges that the Recipient has read the Confidentiality Deed and has been informed by the Principal Recipient of the confidential nature of the Information to be provided by the Provider.

2. In consideration of the Provider agreeing to provide the Information to the Recipient, the Recipient covenants and agrees to observe the provisions of the Confidentiality Deed in all respects as if the Recipient was named in place of the Principal Recipient in the Confidentiality Deed and to that end all applicable terms of the Confidentiality Deed are deemed to be included as terms and conditions of this Deed.

3. The Recipient shall indemnify and hold free and harmless the Principal Recipient from and against any and all claims, damages, losses, liabilities, costs and expenses, which may be incurred by or awarded against the Principal Recipient, resulting from or arising out of the Recipient’s failure to comply

with its obligations under the Confidentiality Deed.

Execution

Executed as a Deed.

Signed by the Recipient in the presence of:

Signature of Witness	Recipient
Occupation	
Address	

Appendix 9: Escrow Deed

Escrow Deed

Esphion Limited

Vendor

and

No 8 Ventures Management Limited

No 8 Ventures

and

Allot Communications Limited

Purchaser

and

Bell Gully

Escrow Agent

Date 7 January 2008

BELL GULLY

AUCKLAND VERO CENTRE, 48 SHORTLAND STREET
PO BOX 4199, AUCKLAND 1140, DX CP20509, NEW ZEALAND

TEL 64 9 916 8800 **FAX** 64 9 916 8801

This **Escrow Deed** is made on 7 January 2008

between	(1)	**Esphion Limited (Vendor)**
and	(2)	**No 8 Ventures Management Limited (No 8 Ventures)**
and	(3)	**Allot Communications Limited (Purchaser)**
and	(4)	**Bell Gully (Escrow Agent)**

Background

A. The Vendor has agreed to sell and the Purchaser has agreed to purchase the Assets and the Business of the Vendor in accordance with the provisions of an agreement for sale and purchase dated 1 January 2008 (the **Agreement**).

B. Under the terms of the Agreement an amount is to be paid to the Escrow Agent and is to be released and paid to No 8 Ventures or the Purchaser in accordance with the provisions of clause 18 of the Agreement.

Agreement

1. Interpretation

1.1 Definitions

In this deed, unless the contrary intention appears:

Business Day means a day (other than a Saturday or Sunday) on which registered banks are open for general banking business in Auckland;

Completion has the meaning given to that term in the Agreement;

Completion Date has the meaning given to that term in the Agreement;

Escrow Amount has the meaning given to that term in the Agreement;

Escrow Payment Date has the meaning given to that term in the Agreement; and

Escrow Period has the meaning given to that term of the Agreement.

1.2 Interpretation

In this deed, unless the contrary intention appears:

(a) words importing one gender include the other genders;

(b) the singular includes the plural and vice versa;

(c) a reference to the Vendor or Purchaser is a reference also to their respective executors, administrators, permitted assigns and successors (as the context may require);

(d) headings are for convenience only and shall not affect interpretation;

(e) references to clauses and schedules are references to clauses and schedules of this deed unless specifically stated otherwise;

(f) references to any legislation or to any provision of any legislation (including regulations and orders) includes:

(i) that legislation or provision as from time to time amended, re-enacted or substituted and, unless otherwise specifically stated, refers to New Zealand legislation and provisions; and

(ii) any statutory instruments, regulations and orders issued under any such legislation or provision; and

(g) any action required pursuant to this deed to be undertaken on any day which is not a Business Day, shall be undertaken on the next Business Day.

2. Escrow

2.1 **Payment**

On the Escrow Payment Date, the Purchaser shall pay, or cause to be paid, the Escrow Amount to the Escrow Agent.

2.2 **Escrow Account**

The Escrow Agent shall hold the Escrow Amount in New Zealand in an interest bearing bank account in the joint names of the Vendor and the Purchaser until the Escrow Amount is to be released in accordance with clause 18.2 of the Agreement.

3. Interest

3.1 **Credit of Interest**

Interest earned on the Escrow Amount shall be for the credit of the person to which the Escrow Amount is paid and if part of the Escrow Amount is paid to the Purchaser and the Vendor proportionately, interest shall be paid in the same proportion.

3.2 **Non-resident Withholding Tax**

The Escrow Agent shall be entitled to deduct non-resident withholding tax or approved issuer levy and administration charges on the interest earned on the Escrow Amount. Any applicable tax deduction certificates will be provided to the Vendor as required by law.

3.3 **Calculation of Interest**

The Escrow Agent shall calculate accrued interest monthly and interest earned shall be reinvested until paid out. Except for any manifest error these calculations shall be deemed final and binding on the parties.

3.4 **Payment of Interest**

When a payment on account of the Escrow Amount is made from the Escrow Account that payment will be accompanied by a payment of accrued interest earned on the relevant part of the Escrow Amount.

4. Release of Escrow Amount

4.1 Release

The Escrow Agent shall only pay and apply the Escrow Amount in accordance with:

a notice signed on behalf of both of the (1) the Purchaser and (2) the Vendor and No 8 Ventures so directing the Escrow Agent in substantially the same form as set out in Schedule 1;

clause 18.2(b) of the Agreement, where the end of the Escrow Period has been reached and no Warranty Claims by the Purchaser against No 8 Ventures in relation to the breach of any of the Key Shareholders' Warranties remain outstanding and the Escrow Agent has not received any notice from the Purchaser stating that a Warranty Claim remains outstanding;

a notice signed by or on behalf of an independent expert appointed under clause 18.4 of the Agreement so directing the Escrow Agent in substantially the same form as set out in Schedule 2; or

the terms of a certified copy of any written:

final judgment, order, declaration, award or finding of a New Zealand court; or

arbitral award entered as a judgment of the High Court of New Zealand;

delivered to it by No 8 Ventures, the Vendor or the Purchaser and accompanied by a certificate by the party delivering it that:

any appeal or application for review in respect of such judgment, order, declaration, award or finding has been determined in favour of that party; or

the period for filing of any appeal or application for review of such judgment, order, declaration, award or finding (and any period during which an application for extension of such period may be made) has expired without an appeal or application having been filed.

4.2 Directions to Escrow Agent

Written directions provided to the Escrow Agent by the parties must be signed by at least one authorised signatory of (1) the Purchaser and (2) the Vendor and No 8 Ventures. The initial authorised signatories of the Purchaser shall be Ovadia Doron Arazi and/or Abraham Zeev Rami Hadar and the initial authorised signatory of the Vendor and No 8 Ventures shall be Mark Edwards..

5. Escrow Agent's Obligations

5.1 **Compliance with Directions**

The Escrow Agent shall promptly comply in relation to the Escrow Amount with any notice, direction or order given to the Escrow Agent in accordance with clause 4.

5.2 **Payment by Direct Transfer**

The Escrow Agent shall make any payment that is due to be made from the Escrow Amount by direct transfer of cleared funds into such bank account as the relevant party may nominate by written notice to the Escrow Agent.

5.3 **Reliance on Notice**

The Escrow Agent shall be entitled to rely on the authenticity of any notice purporting to be signed by a party or parties in accordance with clause 4, including without limitation, any signatures on any notices received by facsimile.

5.4 **No other Obligations**

The Escrow Agent shall have no other obligations to any of the other parties in respect of the escrow except as set out in this deed.

6. Escrow Agent Indemnity

The Purchaser and the Vendor and No 8 Ventures shall at all times jointly and in equal shares fully and effectively indemnify the Escrow Agent against all claims, damages or costs (excluding consequential loss or damage) suffered or incurred by the Escrow Agent (including the Escrow Agent's legal fees on a solicitor and client basis) by reason of:

(a) the Escrow Agent entering into this deed; or

(b) the Escrow Amount being in the Escrow Agent's possession, or

(c) any action taken or proceedings initiated by the Escrow Agent at its sole discretion for the purpose of determining any dispute in relation to the Escrow Amount whether between the parties to this deed or involving any other persons claiming a right to the Escrow Amount,

(other than claims, damages or costs arising from the Escrow Agent's wilful breach, gross negligence or fraud) and the Escrow Agent shall have a lien on the Escrow Amount for any such costs and shall not be obliged to undertake any action or initiate any defence to proceedings whatsoever until and unless they have received payment or satisfactory security in advance from the Purchaser and the Vendor for this indemnity.

7. Announcements

Except as may be required by law or by the listing rules of any relevant stock exchange, no party shall make any announcements or disclosures as to the subject matter or any of the terms of this deed except in such form and manner, and at such time, as the Escrow Agent may consent to.

8. Confidentiality

Each party shall at all times keep confidential, treat as privileged, and not directly or indirectly make or allow any disclosure or use to be made, of any provision of this deed or of any information relating to any provision, or the subject matter, of this deed, or any information directly or indirectly obtained from another party to this deed under or in connection with this agreement, except to the extent:

(a) required by law or by the listing rules of any relevant stock exchange; or

(b) that the parties otherwise agree in writing; or

(c) necessary to obtain the benefit of, or to carry out obligations under, this deed; or

(d) that the information is or becomes available in the public domain without breach by a party of its confidentiality obligations under this clause or at law.

9. Notices

If any party wishes to give any other party any notice, claim, demand or other communication ("**Notice**") under or in connection with this deed, the Notice shall be sufficiently given or served (but without prejudice to any other mode of service) if addressed to that party and delivered to the address of that party stated below.

The Vendor and No 8 Ventures:

C/- PricewaterhouseCoopers
113-119 The Terrace
Wellington

The Purchaser:

22 Hanager Street
Neve Ne'eman Industrial Zone B
Hod Hasharon 45240
Israel

The Escrow Agent:

Bell Gully
PO Box 4199
Level 22, Vero Centre
Shortland Street
Auckland

10. Non-merger

The obligations, warranties, undertakings and indemnities undertaken or given under or pursuant to this deed, to the extent not already performed at Completion, shall not merge on Completion, or on the execution and delivery of any document pursuant to this deed, but shall remain enforceable to the fullest extent and notwithstanding any rule of law to the contrary.

11. No waiver

No waiver of any breach, or failure to enforce any provision, of this deed at any time by any party shall in any way affect, limit or waive the right of such party thereafter to enforce and compel strict compliance with the provisions of this deed.

12. Escrow Agent Lien

Nothing in this deed shall be construed to in any way affect any lien or claim which the Escrow Agent may have in respect of any moneys received by any of the parties including, without limitation, the Escrow Amount.

13. Costs

Each party shall bear its own costs and expenses incurred in connection with the preparation and implementation of this deed.

14. Severability

If at any time it is held by a competent authority that any provision of this deed is illegal or unenforceable for any reason ("**Offending Provision**") and that finding is not overturned or reversed in any appeal process, the Offending Provision shall be deemed to be deleted from this deed, or shall be modified in accordance with the ruling of any competent authority, and thereafter this deed shall continue in full force and effect subject to such deletion or modification.

15. Entire Agreement

15.1 This deed together with the relevant provisions of the Agreement constitutes the entire agreement between the parties with respect to the matters contemplated by this deed and supersedes all prior agreements.

15.2 This deed may only be amended by written agreement signed by all parties.

16. Counterparts

This deed may be signed and delivered in counterparts (including by way of electronic transmission) which together shall constitute one deed binding on the parties, notwithstanding that all parties are not signatories to the original or same counterpart.

17. Facsimile Signature

The parties may sign a counterpart copy of this deed by photocopying a facsimile of this deed and signing that photocopy. The transmission by facsimile by a party of a signed counterpart copy of this deed shall be deemed proof of signature of the original and the signed facsimile so transmitted shall be deemed an original.

18. Governing Law

This deed shall be governed by, and construed in accordance with, the laws of New Zealand. The parties irrevocably submit to the exclusive jurisdiction of the courts of New Zealand in relation to all disputes arising out of or in connection with this deed.

Execution

Executed as a deed.

SIGNED by **Allot Communications Limited** by:

/s/ Rami Hadar	/s/ Doron Arazi
Chief Executive Officer	Chief Financial Officer
Print Name	Print Name

SIGNED by **No 8 Ventures Management Limited** by:

/s/ Mark Edwards	/s/ Kory Fagan
Director/Authorised Signatory	Director/Authorised Signatory
Mark Edwards	Kory Fagan
Print Name	Print Name

SIGNED by **Esphion Limited** by:

/s/ Mark Edwards Director/Authorised Signatory	Director/Authorised Signatory
Mark Edwards Print Name	Print Name

SIGNED by **Bell Gully** as Escrow Agent in the presence of:

/s/ David McPherson

Authorised Signatory Partner

David McPherson

Print Name

Schedule 1: Form of directions to Escrow Agent

[Date]

To: Bell Gully
Level 22, Vero Centre
48 Shortland Street
Attention: Anna Buchly

Escrow Deed dated [ ] 2008 between Esphion Limited, No 8 Ventures Management Limited, Allot Communications Limited and Bell Gully (as Escrow Agent) (Escrow Deed)

Pursuant to clause 4.1(a) of the Escrow Deed, we direct you to make the following payment from the Escrow Amount.

Amount of payment: [ ]
Payee: [ ]
Bank: [ ]
Branch address: [ ]
Bank account number: [ ]

Thank you for your assistance. Please contact [name, telephone number] with any questions about this transaction.

Yours faithfully

Name:

Title:

on behalf of Allot Communications Limited

Name:

Title:

on behalf of Esphion Limited and No 8 Ventures Management Limited

Schedule 2: Independent Expert – Form of Directions to Escrow Agent

[Date]

To: Bell Gully
Level 22, Vero Centre
48 Shortland Street
Attention: Anna Buchly

Escrow Deed dated [ ] 2008 between Esphion Limited, No 8 Ventures Management Limited, Allot Communications Limited and Bell Gully (as Escrow Agent) (Escrow Deed)

Pursuant to clause 4.1(b) of the Escrow Deed, we direct you to make the following payment from the Escrow Amount.

Amount of payment: [ ]
Payee: [ ]
Bank: [ ]
Branch address: [ ]
Bank account number: [ ]

Attached is a copy of our appointment as Independent Expert signed by both the Vendor and the Purchaser in accordance with clause 18.4 of the Agreement.

Thank you for your assistance. Please contact [name, telephone number] with any questions about this transaction.

Yours faithfully

Name:

Title:

on behalf of [*Independent Expert*]

Exhibit 8.1

List of Subsidiaries

Company	Jurisdiction of Incorporation
Allot Communications, Inc.	United States
Allot Communication Europe SARL	France
Allot Communications (Asia Pacific) Pte. Limited	Singapore
Allot Communication (UK) Limited	United Kingdom
Allot Communications Japan K.K.	Japan
Allot Communications (New Zealand) Limited	New Zealand

EXHIBIT 12.1

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Rami Hadar, certify that:

1. I have reviewed this annual report on Form 20-F of Allot Communications Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;

4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: June 27, 2008

/s/ Rami Hadar

Rami Hadar
President and Chief Executive Officer

EXHIBIT 12.2

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Doron Arazi, certify that:

1. I have reviewed this annual report on Form 20-F of Allot Communications Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;

4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: June 27, 2008

/s/ Doron Arazi

Doron Arazi
Chief Financial Officer

EXHIBIT 13.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Allot Communications Ltd. (the “Company”) on Form 20-F for the period ending December 31, 2007, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Rami Hadar and I, Doron Arazi, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 27, 2008

/s/ Rami Hadar

Rami Hadar
President and Chief Executive Officer

Date: June 27, 2008

/s/ Doron Arazi

Doron Arazi
Chief Financial Officer

Exhibit 14.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-140701 and 333-149237) pertaining to the Employee Stock Option Plan of Allot Communications Ltd., of our reports dated June 26, 2008, with respect to the consolidated financial statements of Allot Communications Ltd., and the effectiveness of internal controls over financial reporting of Allot Communications Ltd., included in this Annual Report (Form 20-F) for the year ended December 31, 2007.

/s/ KOST FORER GABBAY & KASIERER

June 26, 2008
Tel-Aviv, Israel

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