

CERAGON NETWORKS LTD
Form 20-F
April 01, 2009

As filed with the Securities and Exchange Commission on April 1, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2008

OR

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

OR

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

For the transition period from _____ to _____

Commission file number 0-30862

CERAGON NETWORKS LTD.

(Exact Name of Registrant as Specified in Its Charter)

Israel

(Jurisdiction of Incorporation or Organization)

24 Raoul Wallenberg Street, Tel Aviv 69719, Israel

(Address of Principal Executive Offices)

Norman Kotler, (+972) 3-645-5733(tel.), (+972) 3-645-5499 (fax), 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel
(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

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

| <u>Title of Each Class</u> | <u>Name of Exchange of Which Registered</u> |
|-------------------------------------|---|
| Ordinary Shares, Par Value NIS 0.01 | Nasdaq Global Market |

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 35,586,701 Ordinary Shares, NIS 0.01 par value.

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

U.S. GAAP

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

Other

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

Item 17 Item 18

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

Yes No

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INTRODUCTION

Definitions

In this annual report, unless the context otherwise requires:

references to Ceragon, the Company, us, we and our refer to Ceragon Networks Ltd. (the Registrant), an Israeli company, and its consolidated subsidiaries;

references to ordinary shares, our shares and similar expressions refer to the Registrant's Ordinary Shares, NIS 0.01 nominal (par) value per share;

references to dollars, U.S. dollars and \$ are to United States Dollars;

references to shekels and NIS are to New Israeli Shekels, the Israeli currency;

references to the Companies Law are to Israel's Companies Law, 5759-1999; and

references to the SEC are to the United States Securities and Exchange Commission.

Cautionary Statement Regarding Forward-Looking Statements

This annual report includes certain statements that are intended to be, and are hereby identified as, forward-looking statements for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events.

Forward-looking statements can be identified by the use of forward-looking terminology such as may, will, expect, anticipate, estimate, continue, believe or other similar expressions, but are not the only way these statements are identified. These statements discuss future expectations, plans and events, contain projections of results of operations or of financial condition or state other forward-looking information. When a forward-looking statement includes an underlying assumption, we caution that, while we believe the assumption to be reasonable and make it in good faith, assumed facts almost always vary from actual results, and the difference between a forward-looking statement and actual results can be material. Forward-looking statements may be found in Item 4: Information on the Company and Item 5: Operating and Financial Review and Prospects and in this annual report generally. Our actual results could differ materially from those anticipated in these statements as a result of various factors, including all the risks discussed in Risk Factors and other cautionary statements in this annual report. All of our forward-looking statements are qualified by and should be read in conjunction with those disclosures. Except as may be required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report might not occur.

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

PART I

Selected Financial Data

The following tables present our consolidated statement of operations and balance sheet data for the periods and as of the dates indicated. The selected financial data have been derived from our audited historical financial statements for each of the years from 2004 to 2008. The selected consolidated statement of income data for the years 2006, 2007, and 2008, and the selected consolidated balance sheet data at December 31, 2007 and 2008, have been derived from our audited consolidated financial statements set forth in Item 18 Financial Statements. The selected consolidated statement of income data for the years 2004 and 2005, and the selected consolidated balance sheet data at December 31, 2004, 2005 and 2006, has been derived from our previously published audited consolidated financial statements, which are not included in this Annual Report on Form 20-F. We prepare our consolidated financial statements in U.S. dollars and in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP). The selected consolidated financial data set forth below should be read in conjunction with Item 5 of this annual report entitled Operating and Financial Review and Prospects and our consolidated financial statements and the notes to those financial statements included elsewhere in this annual report.

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| | Year ended December 31, | | | | |
|---|---|-------------------|------------|------------|------------|
| | 2004 ¹ | 2005 ¹ | 2006 | 2007 | 2008 |
| | (In thousands, except share and per share data) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Revenues | \$ 54,831 | \$ 73,777 | \$ 108,415 | \$ 161,888 | \$ 217,278 |
| Cost of revenues ^{2,3} | 32,227 | 52,487 | 80,776 | 103,406 | 144,607 |
| Gross profit | 22,604 | 21,290 | 27,639 | 58,482 | 72,671 |
| Operating expenses: | | | | | |
| Research and development | 9,772 | 10,713 | 13,336 | 15,457 | 20,310 |
| Less: grants and participations | 2,293 | 1,752 | 1,543 | - | - |
| Research and development, net | 7,479 | 8,961 | 11,793 | 15,457 | 20,310 |
| Selling and marketing | 11,841 | 13,629 | 17,420 | 25,344 | 32,252 |
| General and administrative | 2,485 | 3,134 | 5,170 | 5,277 | 7,150 |
| Expense in respect of settlement reserve | - | - | - | 450 | - |
| Total operating expenses | 21,805 | 25,724 | 34,383 | 46,528 | 59,712 |
| Operating income (loss) | 799 | (4,434) | (6,744) | 11,954 | 12,959 |
| Financial income, net | 674 | 607 | 1,284 | 1,182 | 2,184 |
| Other income | 141 | - | - | - | - |
| Income (loss) before taxes | 1,614 | (3,827) | (5,460) | 13,136 | 15,143 |
| Tax benefit | - | - | - | - | 10,834 |
| Net income (loss) | 1,614 | (3,827) | (5,460) | 13,136 | 25,977 |

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| | Year ended December 31, | | | | |
|--|-------------------------|------------|------------|------------|------------|
| | | | | | |
| Basic net earnings (loss) per share | \$ 0.06 | \$ (0.15) | \$ (0.20) | \$ 0.44 | \$ 0.70 |
| Diluted net earnings (loss) per share | \$ 0.06 | \$ (0.15) | \$ (0.20) | \$ 0.41 | \$ 0.68 |
| Weighted average number of shares used in computing basic earnings (loss) per share | 25,066,937 | 26,137,121 | 26,728,053 | 29,692,670 | 36,863,684 |
| Weighted average number of shares used in computing diluted earnings (loss) per share ⁴ | 28,069,844 | 26,137,121 | 26,728,053 | 32,101,394 | 38,338,584 |

- (1) The deferred stock-based compensation expenses previously presented for the years 2004-2005 in a separate line item were reclassified in the relevant expense line.
- (2) In 2005, the amount includes \$7,082 related to a write-off of inventories and \$390 related to a write-off of long-term receivables.
- (3) In 2006, the amount includes a one-time charge of \$10,444 related to an agreement with the Office of the Chief Scientist to terminate our grant program.
- (4) In 2005 and 2006, all outstanding share options have been excluded from the calculation of diluted net loss per share because all these securities are antidilutive for the periods presented.

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| | At December 31, | | | | |
|--|-----------------|------|------|------|------|
| | 2004 | 2005 | 2006 | 2007 | 2008 |
| | (In thousands) | | | | |

Consolidated Balance Sheet Data:

| | | | | | |
|---|-----------|-----------|-----------|------------|-----------|
| Cash and cash equivalents, short and long term bank deposits, short and long term marketable securities | \$ 37,801 | \$ 33,022 | \$ 29,485 | \$ 121,741 | \$ 97,761 |
| Working capital | 38,827 | 34,871 | 47,268 | 132,420 | 136,294 |
| Total assets | 73,111 | 73,992 | 96,351 | 217,640 | 245,238 |
| Total long term liabilities | 2,986 | 3,424 | 12,277 | 9,936 | 6,647 |
| Shareholders' equity | 52,187 | 49,189 | 47,561 | 160,894 | 182,916 |

Risk Factors

The following risk factors, among others, could affect our actual results of operations and cause our actual results to differ materially from those expressed in forward-looking statements made by us. These forward-looking statements are based on current expectations and we assume no obligation to update this information. You should carefully consider the risks described below, in addition to the other information contained elsewhere in this annual report. The following risk factors are not the only risk factors facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. Our business, financial condition and results of operations could be seriously harmed if any of the events underlying any of these risks or uncertainties actually occur. In that event, the market price for our ordinary shares could decline.

Risks Relating to Our Business

The current economic and financial crisis may have a material adverse effect on our results.

The crisis of the financial and credit markets worldwide in the second half of 2008 has led to an economic slowdown worldwide, and the outlook for 2009 is uncertain. A continuation or worsening of unfavorable economic conditions, including the ongoing credit and capital markets disruptions, could have an adverse impact on our business, operating results or financial condition in a number of ways. For example, our preliminary results for the first quarter of 2009 indicate lower revenues and net income than in both the first and last quarters of 2008. We may experience further declines in revenues, profitability and cash flows as a result of reduced orders, delays in receiving orders or in the completion of projects, delays or defaults in payment or other factors caused by the economic problems of our customers and prospective customers. We may experience supply chain delays, disruptions or other problems associated with financial constraints faced by our suppliers and subcontractors. In addition, changes and volatility in the equity, credit and foreign exchange markets and in the competitive landscape make it increasingly difficult for us to predict our revenues and earnings into the future. Currently, we lack of short-term visibility as customers are focused on maintaining flexibility, reducing inventory and conserving their cash.

We face intense competition from other wireless equipment providers. If we fail to compete effectively, our business, financial condition and results of operations would be materially adversely affected.

The market for wireless equipment is rapidly evolving, fragmented, highly competitive and subject to rapid technological change. Increased competition in the wireless equipment market could result in reduced demand for our products, price reductions and reduced gross margins, any of which could seriously harm our business and results of operations. Our primary competitors include Harris Stratex Networks, Inc., Huawei Technologies Co., Ltd., L.M. Ericsson Telephone Company, NEC Corporation (NEC) and Nokia Siemens Networks B.V. (NSN). In addition to these primary competitors, a number of other communications equipment suppliers, including Alcatel-Lucent, DragonWave Inc., Nera Networks AS, SIAE Microelettronica S.p.A. and ZTE Corporation, offer or are developing products that compete with our products.

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Most of our principal competitors are substantially larger than we are and have longer operating histories and greater financial, sales, marketing, distribution, technical, manufacturing and other resources than we have. They also have greater name recognition and a larger customer base than we have. Many of these competitors have well-established relationships with our current and potential customers and have extensive knowledge of our target markets. As a result, our competitors may be able to respond more quickly to evolving industry standards and changes in customer requirements, or to devote greater resources to the development, promotion and sale of their products than we can. In addition, our competitors, especially those from China, may be able to offer customers financing that would increase the attractiveness of their products in comparison to ours.

Additionally, the telecommunications equipment industry has experienced significant consolidation among its participants, and we expect this trend to continue. In mid-2006, Nokia and Siemens formed a joint venture to merge the Networks Business Group of Nokia and the carrier-related operations of Siemens into NSN. NSN began operations in April 2007. Other examples are the mergers of Alcatel and Lucent and of the wireless divisions of Harris and Stratex Networks, and the acquisition by Ericsson of Marconi. These consolidations have increased the size and thus the competitive resources of these companies. In the future, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that may allow them to increase their market share and competitive position.

We expect to face increasing competitive pressures in the future. If we are unable to compete effectively, our business, financial condition and results of operations would be materially adversely affected.

Global competition and current market conditions, as well as an increase in the concentration of our business in India and other parts of Asia, have resulted in downward pressure on the prices for our products, which could result in reduced revenues, gross margins and profitability.

We operate in the wireless equipment market, which is characterized by vigorous, worldwide competition for market share and by rapid technological development. These factors have resulted in aggressive pricing practices and downward pricing pressures, as well as growing competition from both start-up companies and well-capitalized telecommunication systems providers. Moreover, competition for larger equipment orders is particularly intense since the number of large equipment orders in any year is limited. Consequently, we generally experience greater pricing pressure when we compete for larger orders as a result of this increased competition and demand from purchasers for greater volume discounts. As an increasing portion of our revenues is derived from large orders, we believe that our business will be more susceptible to these pressures.

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Also, in recent years we have increased sales of our products in India and other parts of Asia in response to the rapid build-out of cellular networks in those regions. For the years ended December 31, 2007 and 2008, 42% and 52%, respectively, of our revenues were earned in the Asia/Pacific region. Sales of our products in these markets are generally at lower gross margins in comparison to other regions.

These factors have resulted in a decrease in our gross margins from 36% for the year ended December 31, 2007 to 33% for the year ended December 31, 2008.

If we are unable to effectively respond to these pricing pressures, our revenues, gross margins and profitability could be materially reduced, and our gross margins could continue to be reduced.

We will not be able to sustain our recent revenue growth rate during the current economic crisis and may not be able to regain our recent rate of growth in future periods, which may reduce our share price.

Our revenues have grown rapidly over the last several years. Our revenues for the years ended December 31, 2006, 2007 and 2008 were \$108.4 million, \$161.9 million and \$217.3 million, respectively. You should not rely on our revenue growth in any prior quarterly or annual period as an indication of our future revenue growth. The preliminary results for the first quarter of 2009 indicate that we will not sustain our recent growth rate in the short term and may not be able to regain this rate of growth in future periods. We expect revenues for the first quarter of 2009 to be lower than in the first and last quarters of 2008. If we are unable to maintain adequate revenue growth, our share price may decline. You must consider our business and prospects in light of the risks and difficulties we encounter as a rapidly growing technology company.

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We have a history of operating and net losses. We may not operate profitably in the future.

We have incurred operating and net losses in almost every fiscal year from our inception, other than 2004, 2007 and 2008, and we may incur losses in the future. For the years ended 2005 and 2006, we reported net losses of \$3.8 million and \$5.5 million, respectively. Our results of operations are likely to decline in 2009. Our preliminary estimate of net income for the first quarter of 2009 is that it will be lower than for the first and last quarters of 2008. As of December 31, 2008, our accumulated deficit was \$94.6 million. While we achieved net income of approximately \$26.0 million in the year ended December 31, 2008, we cannot assure you that we will operate profitably in the future or that our profitability will not decline. If we do not sustain our profitability, our share price could decline.

Depending on the impact on our business of the current economic crisis, we may face problems in managing any decline in our business.

If the current economic and financial crisis continues to have an adverse impact on the demand for products or their profitability, we may face difficulties in managing a decline in our business. Our success in handling a contraction of our business will depend on our ability, among other things, to:

- develop efficient forecast methods for evaluating the prospective quantity of products that will be ordered by our customers;
- control inventories of components ordered by our contract manufacturers required to meet actual demand, including but not limited to handling the effects of excess inventories accumulated by such manufacturers;
- reduce the costs of manufacturing our products;
- continue to collect receivables from our customers in full and in a timely manner; and
- properly balance the size and capabilities of our workforce.

If we are unable to manage a decline in business, we could fail to manage the costs associated with all aspects of our business, which would have a material adverse effect on our business and results of operations.

We face intense competition from other high-speed communications solutions that compete with our high-capacity point-to-point wireless products, which could reduce demand for our products and have a material adverse effect on our business and results of operations.

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Our products compete with other high-speed communications solutions, including fiber optic lines, leased copper lines and other wireless technologies. Some of these technologies utilize existing installed infrastructure and have achieved significantly greater market acceptance and penetration than high-capacity point-to-point wireless technologies.

Some of the disadvantages of high capacity, point-to-point wireless technologies that may make other technologies more appealing include:

Extreme Weather Conditions: wireless backhaul solutions may not operate optimally in certain extreme weather conditions, including severe rainfalls or hurricanes; and

Line-of-Sight Limitations: wireless backhaul solutions generally require a direct line-of-sight between antennas. Consequently, service providers often install these solutions on wireless antenna towers, rooftops of buildings and on other tall structures. As a result, service providers must generally secure roof or other property rights from the owners of each building or other structure on which our products are installed. This may delay deployment and increase the installation costs. Some base stations cannot be linked by line-of-sight solutions.

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In addition, customers may decide to use transmission frequencies for which we do not offer products. To the extent that these competing communications solutions reduce demand for high-capacity point-to-point wireless transmission products, this reduction could have a materially adverse effect our business and results of operations.

We are dependent upon sales of our FibeAir® family of products into a single market. Any reduction in demand for these products in this market would cause our revenues to decrease.

We design, develop, manufacture and sell nearly all of our products to meet high-capacity point-to-point wireless backhaul needs. Nearly all of our revenues are generated from sales of our FibeAir® portfolio of products. We expect sales of our FibeAir® portfolio of products to continue to account for nearly all of our revenues for the foreseeable future. As a result, we are more likely to be adversely affected by a reduction in demand for point-to-point wireless backhaul products than companies that sell multiple and diversified product lines or into multiple markets.

We sell a significant portion of our products through a small number of strategic relationships with OEMs at gross margins that are lower than the gross margins for our sales directly to customers, which lowers our overall gross margin. In addition, the loss of one or more of these key OEM relationships would result in a significant loss of revenues.

We market and sell our products to customers increasingly through three OEMs that integrate our solutions into their product offerings. We anticipate that sales to our three OEMs will constitute an increasing portion our business in the future. For the year ended December 31, 2008, sales to NSN, our largest OEM, represented approximately 24% of our revenues.

Our sales to our OEMs are made on the basis of purchase orders rather than long-term purchase commitments. Our relationships with our OEMs are generally governed by non-exclusive agreements that require us to competitively price our products, have no minimum sales commitments and do not prohibit our OEMs from offering products that compete with our solutions. The size of purchases by our OEMs typically fluctuates from quarter-to-quarter and year-to-year, and may continue to fluctuate in the future, which may affect our quarterly and annual results of operations.

Our OEM agreements typically have an initial term between one and five years and automatically renew for successive one year terms. Our agreement with NSN will be renewed on November 1, 2009, unless terminated by either party with three months notice prior to such automatic renewal. Under certain customary circumstances, including failure to remedy a breach within 30 days of receiving written notice, either we or NSN may terminate the agreement. In addition, NSN has the right to terminate the agreement in the event we sell all or substantially all of our assets, merge or consolidate with a third party, or undergo a material change of ownership.

Some of our OEMs also possess significant resources and advanced technical capabilities and may, either independently or jointly with our competitors, develop and market products and related services that compete with our solutions. If either of these were to occur, our OEMs may discontinue marketing, distributing and supporting our solutions. NSN is a competitor with regard to some of our solutions.

Furthermore, sales to our OEMs result in lower gross margins than sales directly to end-users through distributors and re-sellers and expose our business to a number of risks, each of which could result in a reduction in the revenues for our products. By selling our products to OEMs,

we rely in part on the sales and marketing efforts of the OEMs, as well as on their post-sale support. These OEMs may decide to promote competing products or alternative technologies. If our OEMs fail to effectively market and support our products, or if we experience a loss or a substantial reduction in orders from these OEMs, or one of our OEMs terminates its relationship with us, our revenues may decline, and our business, financial condition, and results of operations would be materially adversely affected.

The creation of NSN may lead to fewer purchases of our products by NSN, which would significantly reduce our revenues.

As of November 2005, we entered into an OEM Purchase and Distribution Agreement, which we refer to as the Nokia OEM Agreement, with Nokia Corporation. Under the Nokia OEM Agreement, Nokia agreed to include our products with its microwave radio product portfolio as Nokia PowerHopper Vario to provide complete wireless transmission networking solutions. After the creation of NSN by Nokia and Siemens in mid-2006, Nokia assigned the Nokia OEM Agreement to NSN. During 2007 and 2008, sales to NSN accounted for approximately 10% and 24%, respectively of our revenues. NSN has products and capabilities to develop products that compete with some of ours, and we cannot assure you that NSN will continue to make substantial purchases of our products under the Nokia OEM Agreement. These purchasing decisions can be made by NSN on a regional basis, product basis or customer basis. If NSN decides to promote NSN's current or future products rather than ours, NSN could become a more significant competitor of ours, which could decrease our sales to NSN and significantly reduce our revenues.

Consolidation of our potential customer base could harm our business.

The trend toward mergers in the telecommunications industry has resulted in the consolidation of our potential customer base. In situations where an existing customer consolidates with another industry participant which uses a competitor's products, our sales to that existing customer could be reduced or eliminated completely to the extent that the consolidated entity decides to adopt the competing products. Further, consolidation of our potential customer base could result in purchasing decision delays as consolidating customers integrate their operations and could generally reduce our opportunities to win new customers to the extent that the number of potential customers decreases. Finally, as our customers become larger they may have more leverage to negotiate better pricing which could harm our revenues and gross margins.

We rely on a limited number of contract manufacturers to manufacture our products and if they experience delays, disruptions, quality control problems or a loss in capacity, it could materially adversely affect our operating results.

We outsource all of our manufacturing processes to a limited number of contract manufacturers that are located in Israel and the Philippines. We do not have long-term contracts with any of these contract manufacturers. We have experienced and may in the future experience delays in shipments from these contract manufacturers.

Our contract manufacturers may themselves in the future experience manufacturing problems, including inferior quality and insufficient quantities of components. These delays, disruptions, quality control problems and loss in capacity could result in delays in deliveries of our product to our customers, which could subject us to penalties payable to our customers, increased warranty costs and possible cancellation of orders. If our contract manufacturers experience financial, operational, manufacturing capacity or other difficulties, or shortages in components required for manufacturing, our supply may be disrupted and we may be required to seek alternate manufacturers. We may be unable to secure alternate manufacturers that meet our needs in a timely and cost-effective manner. In addition, some of our contract manufacturers have granted us licenses with respect to certain technology that is used in a number of our products. If we change contract manufacturers, we may be required to renegotiate such licenses or re-design some of our products, either of which could increase our cost of revenues and cause product delivery delays. If we change manufacturers, during such a transition period, we may be more likely to face delays, disruptions, quality control problems and loss in capacity, and our sales, profits and customer relationships may suffer.

Our contract manufacturers obtain some of the components included in our products from a limited group of suppliers and, in some cases, single or sole source suppliers. The loss of any of these suppliers could cause us to experience production and shipment delays and a substantial loss of revenue.

Our contract manufacturers currently obtain key components from a limited number of suppliers. Some of these components are obtained from a single or sole source supplier. Our contract manufacturers' dependence on a single or sole source supplier or on a limited number of suppliers subjects us to the following risks:

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The component suppliers may experience shortages in components and interrupt or delay their shipments to our contract manufacturers. Consequently, these shortages could delay the manufacture of our products and shipments to our customers which could result in penalties and/or cancellation of orders for our products.

The component suppliers could discontinue the manufacture or supply of components used in our systems. In such an event, our contract manufacturers or we may be unable to develop alternative sources for the components necessary to manufacture our products, which could force us to redesign our products. Any such redesign of our products would likely interrupt the manufacturing process and could cause delays in our product shipments. Moreover, a significant modification in our product design may increase our manufacturing costs and bring about lower gross margins.

The component suppliers may increase component prices significantly at any time and with immediate effect, particularly if demand for certain components increases dramatically in the global market. These price increases would increase component procurement costs and could significantly reduce our gross margins and profitability.

We may acquire other businesses, which could result in integration problems and adversely affect our business.

We may acquire other businesses. In the event that we consummate such transactions, we may be subject to risks such as an inability to effectively integrate our sales force and manufacture and distribute our products and services and an inability to effectively integrate the technology and other processes of the acquired businesses. Such acquisitions may also subject us to risks relating to:

- the diversion of management's attention from our core business during the integration process;
- the management of a larger combined business, including implementing adequate internal controls;
- the loss of key employees of the acquired businesses; and
- unanticipated losses in the event the acquisition is not consummated.

However, the acquired businesses may not achieve the anticipated benefits or result in writedown or in result of impairment charges. In the event that we consummate the acquisition of other businesses, these challenges and uncertainties could have a material adverse effect on our business, financial condition and results of operations.

Our ability to grow depends on acceptance by our customers of IP-based solutions and our ability to develop and introduce IP-based products.

The market for IP-based backhaul equipment for mobile networks is just beginning to evolve. Our future success depends in part on the acceptance by customers of IP-based networks, IP-based or hybrid backhaul solutions and IP-based or hybrid products that we are developing. We cannot control third-party adoption of IP-based backhaul over competing backhaul solutions such as fiber optic lines. Moreover, our future success depends on our ability to design and manufacture IP-related products that satisfy our customers' evolving and changing needs for IP-based networks and for IP-based backhaul. If the IP-based backhaul for mobile networks market does not develop at the rate we expect as a result of alternative or changing technologies, changes in product standards and regulation, inability to gain customer acceptance or for any other reason, our future growth, business, financial condition, and results of operations may be materially adversely affected.

If we do not succeed in developing and marketing new products that keep pace with technological developments, changing industry standards and our customers' needs, we may not be able to grow our business.

The market for our products is characterized by rapid technological advances, changing customer needs and evolving industry standards, as well as increasing pressures to make existing products more cost efficient. Accordingly, our success will depend on our ability to:

- develop and market new products in a timely manner to keep pace with developments in technology;
- meet evolving customer requirements;

enhance our current product offerings, including technological improvements which reduce the cost and manufacturing time; and deliver products through appropriate distribution channels.

In addition, the wireless equipment industry is subject to evolving industry standards. The emergence or evolution of new industry standards for wireless products, through official standards committees or widespread use by operators, could require us to modify our products. Any such modifications may be expensive and time-consuming or we may not be able to meet these standards at all. If new industry standards emerge that we do not anticipate, our products could be rendered obsolete and we may be required to modify our products in ways that could increase our product costs and adversely affect our profitability.

We are continuously seeking to develop new products and enhance our existing products. Developing new products and product enhancements requires research and development resources and cooperation with subcontractors. We may not be successful in enhancing our existing products or developing new products in response to technological advances or to satisfy increasingly sophisticated customer needs in a timely and cost-effective manner which would have a material adverse effect on our ability to grow our business.

We rely on a limited number of contractors as part of our research and development efforts.

We conduct a part of our research and development activities through outside contractors. We depend on our contractors' ability to achieve stated milestones and commercialize our products, and on their ability to cooperate and overcome design difficulties. Our contractors may experience problems, including the inability to recruit professional personnel, which could delay our research and development process. These delays could:

increase our research and development expenses;

delay the introduction of our upgraded and new products to current and prospective customers and our penetration into new markets; and

adversely affect our ability to compete.

If our contractors fail to perform, we may be unable to secure alternative contractors that meet our needs. Moreover, qualifying new contractors may also increase our research and development expenses.

Our sales cycles in connection with competitive bids or to prospective customers are lengthy.

It typically takes from three to twelve months after we first begin discussions with a prospective customer before we receive an order from that customer. In some instances, we participate in competitive bids in tenders issued by our customers or prospective customers. These tender processes can continue for many months before a decision is made by the customer. As a result, we are required to devote a substantial amount of time and resources to secure sales. In addition, the lengthy sales cycle results in greater uncertainty with respect to any particular sale, as events may occur during the sales cycle that impact customers' decisions which, in turn, increases the difficulty of forecasting our results of operations. During the current global economic crisis, we have experienced a lengthening of our sales cycle and a stretching out of the planned timeline for new customer projects and purchasing decisions.

We sell other manufacturers' products as an OEM, which subjects us to various risks that may cause our revenues to decline.

We sell a limited number of products on an OEM basis through relationships with a number of manufacturers. These manufacturers have chosen to sell a portion of their systems through us in order to take advantage of our reputation and sales channels. The sale of these OEM products by us depends in part on the quality of these products, the ability of these manufacturers to deliver their products to us on time and their ability to provide both presale and post-sale support. Sales of OEM products by us expose our business to a number of risks, each of which could result in a reduction in the sales of our products. We face the risks of termination of these relationships, technical and financial problems these companies might encounter or the promotion of their products through other channels and turning them into competitors rather than partners. If any of these risks materialize, we may not be able to develop alternative sources for these OEM products, which may cause our revenues to decline.

Our products are used in critical communications networks which may subject us to significant liability claims.

Since our products are used in critical communications networks, we may be subject to significant liability claims if our products do not work properly. The provisions in our agreements with customers that are intended to limit our exposure to liability claims may not preclude all potential claims. In addition, any insurance policies we have may not adequately limit our exposure with respect to such claims. We warrant to our current customers that our products will operate in accordance with our product specifications. If our products fail to conform to these specifications, our customers could require us to remedy the failure or could assert claims for damages. Liability claims could require us to spend significant time and money in litigation or to pay significant damages. Any such claims, whether or not successful, would be costly and time-consuming to defend, and could divert management's attention and seriously damage our reputation and our business.

Uncertainty and possible delays in deployment of advanced wireless and other networks could cause our revenues to be lower than expected.

Our sales depend on the deployment of advanced wireless networks and other networks. Any delay by wireless service providers in their network deployment schedules could result in lower than expected revenues for us, since these delays would also delay purchasing decisions by the wireless providers.

Due to the growing volume of our sales to developing countries, we are susceptible to a number of political and economic risks that could have a material adverse effect on our business, financial condition and results of operations.

A majority of our sales are made in countries in Asia, Africa, Europe (including eastern Europe) and the Middle East. For the year ended December 31, 2008, sales in these regions accounted for approximately 83% of our revenues. As a result, the occurrence of any international, political or economic events that adversely affects our business could result in significant revenue shortfalls. Any such revenue shortfalls could have a material adverse effect on our business, financial condition and results of operations. The following are some of the risks and challenges that we face doing business internationally, several of which are more likely in the emerging markets than in other countries:

- unexpected changes in regulatory requirements;
- fluctuations in foreign currency exchange rates;
- imposition of tariffs and other barriers and restrictions;
- management and operation of an enterprise spread over various countries;
- burden of complying with a variety of foreign laws;
- general economic and geopolitical conditions, including inflation and trade relationships;
- longer sales cycles;
- difficulties in protecting intellectual property;
- laws and business practices favoring local competitors;
- demand for high-volume purchases with discounted prices;

- payment delays and uncertainties; and
- civil unrest, war and acts of terrorism.

We are increasingly engaged in supplying installation or turnkey projects for our customers which are subject to acceptance testing procedures. Any delay or failure in such acceptance tests would have a material adverse effect on our results of operations.

As we continue to expand our geographic footprint, we are increasingly engaged in supplying installation and other services for our customers, often in developing nations. In this context, we may act as prime contractor and equipment supplier for network build-out projects, providing installation, supervision and testing services required for these projects, or we may provide such services and equipment for projects handled by system integrators. In such cases, we typically bear the risks of loss and damage and title to our products until the customer has issued an acceptance certificate upon successful completion of acceptance tests. If our products are damaged or stolen, or if the network we install does not pass the acceptance tests, the end user or the system integrator, as the case may be, could refuse to pay us and we would incur substantial costs, including fees owed to our installation subcontractors, increased insurance premiums, transportation costs, and expenses related to repairing or manufacturing the products. Moreover, in such a case, we may not be able to repossess the equipment, thus suffering additional losses.

If we fail to obtain regulatory approval for our products, or if sufficient radio frequency spectrum is not allocated for use by our products, our ability to market our products may be restricted.

Radio communications are subject to regulation in most jurisdictions and to various international treaties relating to wireless communications equipment and the use of radio frequencies. Generally, our products must conform to a variety of regulatory requirements established to avoid interference among users of transmission frequencies and to permit interconnection of telecommunications equipment. Any delays in compliance with respect to our future products could delay the introduction of those products. Also, these regulatory requirements may change from time to time, which could affect the design and marketing of our products as well as the competition we face from other suppliers products.

In addition, in most jurisdictions in which we operate, users of our products are generally required to either have a license to operate and provide communications services in the applicable radio frequency or must acquire the right to do so from another license holder. Consequently, our ability to market our products is affected by the allocation of the radio frequency spectrum by governmental authorities, which may be by auctions or other regulatory selection. These governmental authorities may not allocate sufficient radio frequency spectrum for use by our products or we may not be successful in obtaining regulatory approval for our products from these authorities. Historically, in many developed countries, the lack of available radio frequency spectrum has inhibited the growth of wireless telecommunications networks. If sufficient radio spectrum is not allocated for use by our products, our ability to market our products may be restricted which would have a materially adverse effect on our business, financial condition and results of operations. Additionally, regulatory decisions allocating spectrum for use in wireless backhaul at frequencies used by our competitors products could increase the competition we face.

Other areas of regulation and governmental restrictions, including tariff on imports and technology controls on exports, could adversely affect our operations and financial results.

Widespread use of wireless products may have health and safety risks.

Our wireless communications products emit electromagnetic radiation. In recent years, there has been publicity regarding the potentially negative direct and indirect health and safety effects of electromagnetic emissions from wireless telephones and other wireless equipment sources, including allegations that these emissions may cause cancer. Health and safety issues related to our products may arise that could lead to litigation or other actions against us or to additional regulation of our products. We may be required to modify our technology and may not be able to do so. We may also be required to pay damages that may reduce our profitability and adversely affect our financial condition. Even if these concerns prove to be baseless, the resulting negative publicity could affect our ability to market these products and, in turn, could harm our business and results of operations. Claims against other wireless equipment suppliers or wireless service providers could adversely affect the demand for our backhaul solutions.

Part of our inventory may be written off, which would increase our cost of revenues. In addition, we may be exposed to inventory-related losses on inventories purchased by our contract manufacturers.

Inventory of raw materials, work in-process or finished products may accumulate in the future, and we may encounter losses due to a variety of factors including:

new generations of products replacing older ones;

the need of our contract manufacturers to order raw materials that have long lead times and our inability to estimate exact amounts and types of items thus needed, especially with regard to the frequencies in which the final products ordered will operate; and

changes in products because of technological advances and cost reduction measures.

Further, our inventory of finished products may accumulate if a customer were to cancel an order or refuse to physically accept delivery of our products. The rate of such accumulation may increase in a period of economic downturn.

Our contract manufacturers are required to purchase inventory based on manufacturing projections we provide to them. If our actual orders from our customers are lower than these manufacturing projections, our contract manufacturers will have excess inventory of raw materials or finished products which we would be required to purchase.

In addition, we require our contract manufacturers from time to time to purchase more inventory than is immediately required, and to partially assemble components, in order to shorten our delivery time in case of an increase in demand for our products. In the absence of such increase in demand, we may need to compensate our contract manufacturers.

If we are required to purchase excess inventory from our contract manufacturers or otherwise compensate our contract manufacturers for purchasing excess inventory, our business, financial condition, and results of operations could be materially adversely affected.

We also may purchase components or raw materials from time to time for use by our contract manufacturers in the manufacturing of our products. These purchases are based on our own manufacturing projections. If our actual orders are lower than these manufacturing projections, we may accumulate excess inventory which we may be required to write-off. If we are forced to write-off this inventory other than in our ordinary course of business, our business, financial condition, results of operations could be materially adversely effected.

If we are unable to protect our intellectual property rights, our competitive position may be harmed.

Our ability to compete will depend, in part, on our ability to obtain and enforce intellectual property protection for our technology internationally. We currently rely upon a combination of trade secret, trademark and copyright laws, as well as contractual rights, to protect our intellectual property.

Until recently, we have not aggressively pursued patent protection and consequently, our patent portfolio may not be as extensive as those of our competitors. As a result, we may have limited ability to assert any patent rights in negotiations with, or in counterclaiming against, competitors who assert intellectual property rights against us.

We also enter into confidentiality, non-competition and invention assignment agreements with our employees and contractors engaged in our research and development activities, and enter into non-disclosure agreements with our suppliers and certain customers so as to limit access to and disclosure of our proprietary information. We cannot assure you that any steps taken by us will be adequate to deter misappropriation or impede independent third-party development of similar technologies. Moreover, under current law, we may not be able to enforce the non-competition agreements with our employees to their fullest extent.

We cannot assure you that the protection provided to our intellectual property by the laws and courts of foreign nations will be substantially similar to the remedies available under U.S. law. Furthermore, we cannot assure you that third parties will not assert infringement claims against us based on foreign intellectual property rights and laws that are different from those established in the United States. Any such failure or inability to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business, results of operations and financial condition.

Defending against intellectual property infringement claims could be expensive and could disrupt our business.

The wireless equipment industry is characterized by vigorous protection and pursuit of intellectual property rights, which has resulted in often protracted and expensive litigation. NEC, another wireless equipment provider, has asserted that we have been using its intellectual property in certain of our products, and we are in discussions concerning NEC's allegation. On August 8, 2007, we made a settlement offer to NEC in order to fully resolve NEC's allegations. This settlement offer included a lump sum payment of \$450,000 and certain other cross-licensing arrangements in consideration for a release of any potential claim of infringement relating to NEC's allegations. We are currently awaiting a response from NEC. We believe that our products do not infringe NEC's patents and that we have meritorious defenses if

infringement is alleged. However, we are not able to estimate the outcome of the discussions with NEC, including whether there could be an adverse effect on our business. In light of the offer we made to NEC, a provision of \$450,000 was included in our financial statements as of December 31, 2008.

We are involved in discussions with another party regarding the licensing of that party's intellectual property, but we are unable to estimate the outcome of such discussions. We may in the future be notified that we are infringing certain patent or other intellectual property rights of others. Any such litigation or claim, including any litigation or claim resulting from NEC's assertion, could result in substantial costs and diversion of resources. In the event of an adverse result of any such litigation, we could be required to pay substantial damages (including potentially treble damages and attorney's fees should a court find such infringement willful), cease the use and licensing of allegedly infringing technology and the sale of allegedly infringing products and expend significant resources to develop non-infringing technology or to obtain licenses for the infringing technology. We cannot assure you that we would be successful in developing such non-infringing technology or that any license for the infringing technology would be available to us on commercially reasonable terms, if at all.

If we fail to attract and retain qualified personnel, our business, operations and product development efforts may be materially adversely affected.

Our products require sophisticated research and development, marketing and sales, and technical customer support. Our success depends on our ability to attract, train and retain qualified personnel in all these areas. We compete with other companies for personnel in all of these areas and we may not be able to hire sufficient personnel to achieve our goals or support the anticipated growth in our business. The market for the highly-trained personnel we require is competitive, due to the limited number of people available with the necessary technical skills and understanding of our products and technology. If we fail to attract and retain qualified personnel due to compensation or other factors, our business, operations and product development efforts would suffer.

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

In 2008, we derived the majority of our revenues in U.S. dollars. Although a majority of our revenues were denominated in U.S. dollars, a portion of our expenses were denominated in New Israeli shekels, or NIS, and to a significantly lesser extent in euros. Our NIS-denominated expenses consist principally of salaries and related costs and related personnel expenses. We anticipate that a portion of our expenses will continue to be denominated in NIS. In 2008, the NIS fluctuated significantly in comparison to the U.S. dollar, devaluating by 13% in the first half of the year and then appreciating by approximately 13% in the second half of the year. In total, during 2008, the NIS devaluated by 1.14% in comparison to the U.S. dollar. If the U.S. dollar weakens against the NIS in the future, 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. In some cases, we are paid in local currencies or maintain monetary assets in local currencies, creating additional exposure to the risk of devaluation of such currencies relative to the dollar.

If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences, including higher tax rates and potentially punitive interest charges on the proceeds of share sales.

We do not believe that during the year ended December 31, 2008 we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Foreign companies may generally be characterized as a PFIC if for any taxable year 75% or more of such company's gross income is passive income, or at least 50% of the average value of all such company's assets are held for the production of, or produce, passive income. 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 ordinary shares treated as ordinary income, rather than capital gain income, and having potentially punitive interest charges apply to the proceeds of share sales.

It is possible that the Internal Revenue Service will attempt to treat us as a PFIC for the taxable year ending December 31, 2009 or prior years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of our future income, assets, activities and market capitalization, including fluctuations in the price of our ordinary shares, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC in 2009 or in subsequent years. For a discussion of the rules relating to passive foreign investment companies and related tax consequences, please see the section of this annual report entitled "U.S. Federal Income Tax Considerations."

Our operating results may vary significantly from quarter to quarter and these quarterly variations in operating results, as well as other factors, may contribute to the volatility of the market price of our shares.

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Our quarterly results are difficult to predict and may vary significantly from quarter to quarter. Most importantly, delays in product delivery or completion of a sale can cause our revenues and net income to fluctuate significantly from anticipated levels. Furthermore, we may temporarily reduce prices in response to competition or increase spending in order to pursue new market opportunities. Additionally, the following factors may also cause fluctuations in our quarterly results:

- volume and timing of product orders received and delivered during the quarter;
- the ability of our contract manufacturers to manufacture products on time;
- the timing of when our customers provide acceptance certificates in turnkey projects;
- timing of new product introductions by us or our competitors;
- changes in the mix of products sold by us;
- cost and availability of components and subsystems;
- adoption of new technologies and industry standards;
- competitive factors, including pricing, availability and demand for competing products;
- ability of our customers to obtain financing to enable their purchase of our products;
- fluctuations in foreign currency exchange rates;
- worldwide regulatory developments; and
- general economic conditions in the United States and internationally.

The quarterly variation of our operating results, may, in turn, create volatility in the market price for our shares. Other factors that may contribute to wide fluctuations in our market price, many of which are beyond our control, include, but are not limited to:

- announcements of technological innovations;
- customer orders or new products or contracts;
- competitors' positions in the market;
- changes in financial estimates by securities analysts;
- our earnings releases and the earnings releases of our competitors; and
- the general state of the securities markets (with particular emphasis on the technology and Israeli sectors thereof).
- the general state of the credit markets, the current volatility of which could have an adverse effect on our investments.

In addition to the volatility of the market price of our shares, the stock market in general and the market for technology companies in particular have been highly volatile and at times thinly traded. Investors may not be able to resell their shares following periods of volatility.

Due to the size of their shareholdings, Yehuda and Zohar Zisapel have influence over matters requiring shareholder approval.

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As of March 15, 2009, Yehuda Zisapel beneficially owned, directly or indirectly, 6.6% of our outstanding ordinary shares; and Zohar Zisapel beneficially owned, directly or indirectly, 12.8% of our outstanding ordinary shares. Yehuda and Zohar Zisapel are brothers who do not have a voting agreement. As a result, these shareholders may influence the outcome of various actions that require shareholder approval.

Provisions of our Articles of Association, Memorandum of Association and Israeli law could delay, prevent or make difficult a change of control and therefore depress the price of our shares.

The Israeli Companies Law, or the Companies Law, generally provides that a merger be approved by the board of directors and by a majority of shareholders, and has specific provisions for determining the majority of the shareholder vote. However, with respect to companies such as ours which were incorporated prior to the effectiveness of the Companies Law, shareholder approval of a merger must be obtained by at least 75% of the shares participating at the shareholders' meeting and voting thereon, not taking into account any abstentions. Shareholders may resolve to lower this super-majority requirement; however, such a resolution must be approved by at least a 75% majority. Moreover, the modification of our Memorandum of Association requires a 75% majority vote, and such a requirement may subject certain types of merger transactions or other business combinations to the same super-majority approval requirements. Additionally, upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations to creditors. Further, a merger generally may not be completed until the passage of certain time periods. In certain circumstances, an acquisition of shares in a public company must be made by means of a tender offer. Our Articles of Association provide that our directors (other than the external directors) are divided into two classes: Class I and Class II. A director will generally serve for a term ending on the date of the third annual general meeting following the annual general meeting at which such director was elected. This election mechanism may discourage a takeover of our company.

Furthermore, certain provisions of other Israeli laws may have the effect of delaying, preventing or making more difficult an acquisition of or merger with us, which could depress our share price. For example, Israeli tax law treats some acquisitions, such as share-for-share exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. In addition, a merger, which may include the acquisition of more than 25% of the share capital of our company, may be subject to approval by the Israeli Controller of Restrictive Trade Practices, who may impede or delay a merger in accordance with the Restrictive Trade Practices Law, 1988. Finally, we must comply with the requirements of the Israeli Law for the Encouragement of Industrial Research and Development of 1984 and regulations promulgated there under, which we refer to as the R&D Law, which may restrict our ability to consummate a merger or similar transaction.

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Risks Relating to Our Location in Israel

Conditions in Israel may limit our ability to produce and sell our products. This could result in a decrease of our revenues.

Our principal offices and research and development facilities, and the majority of our contract manufacturers' facilities are located in Israel. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any major hostilities involving Israel;
- the interruption or curtailment of trade between Israel and its present trading partners;
- a full or partial mobilization of the reserve forces of the Israeli army; and
- a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. In the summer of 2006, Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group, along Israel's northern border, which involved daily missile strikes that disrupted most day-to-day civilian activity in northern Israel. In an attempt to stop missile strikes from the Gaza Strip against Israelis, in January 2009 Israel became engaged in an armed conflict with Hamas in the Gaza Strip, during which missile attacks aimed at populated areas in parts of southern Israel (some of which are in vicinity of warehouse space we use) continued daily, disrupting most day-to-day civilian activity in these areas. These developments have further strained relations between Israel and the Palestinians. Any on-going or future violence between Israel and the Palestinians, armed conflicts, terrorist activities, tension along Israel's northern borders, or political instability in the region would likely disrupt international trading activities in Israel and may materially and negatively affect our business conditions and those of our major contract manufacturers and could harm our results of operations.

Risks Relating to Our Location in Israel

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Certain countries, as well as certain companies and organizations, continue to participate in a boycott of Israeli firms and others doing business with Israel and Israeli companies. Thus, there have been sales opportunities that we could not pursue and there may be such opportunities in the future from which we will be precluded. For example, certain countries participating in the boycott described above have recently been increasing their investment in telecom operators in Africa. This growing control of the market in Africa could lead to a decrease of our sales in Africa in the future. We are also precluded from marketing our products to certain of these countries due to U.S. and Israeli regulatory restrictions. In addition, such boycott, restrictive laws, policies or practices may change over time and we cannot predict which countries, as well as whether certain companies and organizations, will be subject thereto. The boycott, restrictive laws, policies or practices directed towards Israel or Israeli businesses could, individually or in the aggregate, have a material adverse affect on our business in the future.

Some of our executive officers and employees in Israel are, unless exempt, 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 time 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.

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We can give no assurance that the political and security situation in Israel, as well as the economic situation, will not have a material impact on our business in the future.

Since we received Israeli government grants for research and development expenditures, we are subject to ongoing restrictions and conditions, including restrictions on our ability to manufacture products and transfer technologies outside of Israel.

We received grants from the Government of Israel through the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor, or the OCS, for the financing of a significant portion of our research and development expenditures in Israel through the end of 2006. We therefore must comply with the requirements of the R&D Law. Under the R&D Law, we cannot transfer technology developed with OCS grants, including by the sale of the technology, the grant of a license of such technology or the manufacture of a significant amount of our products that are based on such technology outside of Israel, unless we obtain the approval of an OCS committee. There is no assurance that we will receive such OCS approvals. Even if such OCS approvals are obtained, we may be required to pay additional royalties to the OCS or, in case of a transfer of the technology outside of Israel, a percentage of the consideration paid for such transfer equal to the ratio of the aggregate amount of OCS grants received by us and the aggregate amount of all cash investments made in our company, including the OCS grants. If we fail to comply with any of the requirements of the R&D Law and of those imposed by the OCS, we may be required to pay additional royalties to the OCS together with interest and penalties, and we may be subject to criminal charges. In addition, under the R&D Law, any non-Israeli who becomes a direct holder of 5% or more of our share capital is required to notify the OCS and to undertake to observe the law governing the grant programs of the OCS, the principal restrictions of which are the transferability limits described above in this paragraph.

In December 2006, we entered into an agreement with the OCS to conclude our research and development grant programs sponsored by the OCS. Under the agreement, we were obligated to repay the OCS approximately \$11.9 million in outstanding grants, in six semiannual installments from 2007 through 2009. During the second quarter of 2008, we paid the OCS approximately \$7.4 million to retire all the debt remaining from this agreement. We entered into this agreement because we believed that accelerating the interest-bearing royalty payments to the OCS would reduce our aggregate interest payments relating to the repayment of the grants. The agreement with the OCS will impact our future results of operations in two respects: first, we will no longer receive additional grants from the OCS, which would have offset our research and development costs; second, we will no longer record expenses relating to royalty payments to the OCS. As a result of our agreement with the OCS, we recorded non-recurring expenses of \$10.4 million in 2006 as part of our cost of revenues. Our agreement with the OCS does not amend the terms of the OCS grants we received, and does not release us from continued compliance with the provisions of the R&D Law.

The tax benefits to which we are currently entitled from our approved enterprise program require us to satisfy specified conditions. If we fail to satisfy these conditions, we may be required to pay increased taxes and would likely be denied these benefits in the future.

The Investment Center of the Ministry of Industry, Trade and Labor has granted approved enterprise status to investment programs at our facility in Tel Aviv. When we begin to generate taxable income from these approved enterprise programs, the portion of our income derived from these programs will be exempt from tax for a period of two years and will be subject to a reduced tax for an additional eight years thereafter, depending on the percentage of our share capital held by non-Israelis. The benefits available to an approved enterprise program are dependent upon the fulfillment of conditions stipulated under applicable law and in the certificate of approval. If we fail to comply with these conditions, in whole or in part, or fail to get approval in whole or in part, we may be required to pay additional taxes for the period in which we benefited from the tax exemption or reduced tax rates and would likely be denied these benefits in the future. The amount by which our taxes would increase will depend on the difference between the then applicable tax rate for non-approved enterprises and the rate of tax, if any, that we

would otherwise pay as an approved enterprise, and the amount of any taxable income that we may earn in the future.

The tax benefits available to approved enterprise programs may be reduced or eliminated in the future. This would likely increase our tax liability.

The Israeli government may reduce or eliminate in the future tax benefits available to approved enterprise programs. Our approved program and the resulting tax benefits may not continue in the future at their current levels or at any level. The termination or reduction of these tax benefits would likely increase our tax liability. The amount, if any, by which our tax liability would increase will depend upon the rate of any tax increase, the amount of any tax benefit reduction, and the amount of any taxable income that we may earn in the future.

It may be difficult to enforce a U.S. judgment against us, and our officers and directors named in this annual report, to assert U.S. securities laws claims in Israel and to serve process on substantially all of our officers and directors.

We are incorporated under the laws of the State of Israel. Service of process upon us and our directors and officers, substantially all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, because the majority of our assets and investments, and substantially all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or any of them may not be collectible within the United States. It may be difficult to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. 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 these matters.

Subject to specified time limitations and legal procedures, Israeli courts may enforce a U.S. final judgment in a civil matter, including a judgment based upon the civil liability provisions of the U.S. securities laws, and including a judgment for the payment of compensation or damages in a non-civil matter, provided that:

the judgment was given by a court which was, according to the laws of the state of the court, competent to give it;

the judgment is executory in the state in which it was given;

the judgment is no longer appealable;

the judgment was not given by a court that is not competent to do so under the rules of private international law applicable in Israel;

there has been due process;

the obligation imposed by the judgment is enforceable according to the rules relating to the enforceability of judgments in Israel and the substance of the judgment is not contrary to public policy;

the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties; and

an action between the same parties in the same matter is not pending in any Israeli court or tribunal at the time the lawsuit is instituted in the U.S. court.

Even if these conditions are satisfied, an Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated under the laws of the State of Israel on July 23, 1996 as Giganet Ltd. We changed our name to Ceragon Networks Ltd. on September 6, 2000. We operate under the Israeli Companies Law. Our registered office is located at 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel and the telephone number is 011-972-3-645-5733. Our world wide web address is www.ceragon.com. Information contained on our website does not constitute a part of this annual report.

Our agent for service of process in the United States is Ceragon Networks, Inc., our wholly owned U.S. subsidiary and North American headquarters, located at 10 Forest Avenue, Suite 120, Paramus, New Jersey 07652.

In the years ended December 31, 2008, 2007 and 2006, our capital expenditures were \$5.0 million, \$2.9 million and \$1.4 million, respectively, and were spent primarily on investment in production test equipment, information-technology systems, equipment for research and development, general computer software and hardware and leasehold improvements. We have no current commitments for capital expenditures.

B. Business Overview

We are a leading provider of high capacity wireless backhaul solutions that enable wireless service providers to deliver voice and premium data services, such as Internet browsing, music and video applications. Our wireless backhaul solutions use microwave technology to transfer large amounts of network traffic between base stations and the infrastructure at the core of the mobile network.

We design our solutions to provide fiber-like connectivity for circuit-switched, or SONET/SDH, networks, next generation Ethernet/Internet Protocol, or IP-based, networks, and hybrid networks that combine circuit-switched and IP-based networks. Our solutions support all wireless access technologies, including GSM, CDMA, EV-DO and WiMAX. These solutions address wireless service providers' need to cost-effectively build out and scale their infrastructure to meet the increasing demands placed on their networks by growing numbers of subscribers and the increasing demand for premium data services.

We also provide our solutions to businesses and public institutions that operate their own private communications networks. Our solutions are deployed by more than 150 service providers of all sizes, as well as in hundreds of private networks, in nearly 100 countries.

Industry Background

Wireless communication is increasingly a medium of choice for the access and transport of voice and premium data services. The market for high-capacity wireless backhaul solutions is comprised of both circuit-switched and IP-based solutions. The market for wireless backhaul is being generated primarily by wireless service providers and businesses and public institutions operating private networks.

The rapid growth in demand for high capacity backhaul solutions has been driven by global subscriber growth, particularly in emerging markets, new wireless network build-outs in developing countries and strong consumer demand for mobile data services in developed countries. These trends have significantly increased the amount of traffic that must be accommodated by wireless service providers' backhaul infrastructure. As a result, existing backhaul capacity is heavily strained, creating a bottleneck that hinders service delivery and quality. Service providers are increasingly meeting their backhaul needs by deploying high capacity point-to-point wireless links. These providers are also beginning to upgrade their communications infrastructure to IP-based networks that have significantly greater capacity to accommodate high bandwidth premium data services. The deployment of these IP-based networks requires additional investment in high capacity backhaul solutions. In addition, as some wireless service providers upgrade their infrastructure from circuit-switched to IP-based networks, they require hybrid backhaul solutions which accommodate both types of transmission architectures.

Wireless Service Providers

In order to address the strain on backhaul capacity, wireless service providers have a number of alternatives, including leasing existing copper or fiber lines, laying new fiber optic networks or deploying wireless backhaul solutions. Leasing existing lines requires a significant increase in operating expenses and, in some cases, requires the wireless service provider to depend on a direct competitor. Laying new fiber-optic lines is capital-intensive and these lines cannot be rapidly deployed. The deployment of high capacity point-to-point wireless links

represents a scalable, flexible and cost-effective alternative for expanding backhaul capacity. Wireless backhaul solutions enable wireless service providers to add capacity only as required while significantly reducing upfront and ongoing backhaul costs.

Private Networks

Many large businesses and public institutions require private high bandwidth communication networks to connect multiple locations. These private networks are typically built using IP-based communications infrastructure. This market includes educational institutions, utility companies, municipalities and public safety defense contractors. These customers continue to invest in their private communications networks for numerous reasons, including security concerns, the need to exercise control over network service quality and redundant network access requirements. As data traffic on these networks rises, we expect that businesses and public institutions will continue to invest in their communications infrastructure, including backhaul equipment. Like wireless service providers, customers in this market demand a highly reliable, cost-effective backhaul solution that can be easily installed and scaled to their bandwidth requirements.

Our Solutions

We offer a broad portfolio of innovative, field-proven, high capacity wireless backhaul solutions which enable wireless service providers to eliminate the backhaul capacity bottleneck, significantly reduce backhaul costs and transition to next generation IP-based networks. We also provide solutions to businesses and public institutions that operate their own private communications networks. We believe our solutions have proven their ability to provide high performance in a cost-effective manner, and they are differentiated in the following ways:

Leading Offering for Existing Backhaul Market. We believe that we provide our customers with a leading offering of high capacity wireless backhaul solutions for the broader wireless backhaul market. Our competitive differentiation is demonstrated by our relationship with Nokia Siemens Networks B.V., or NSN, and other leading OEMs, as well as by our global customer base. This differentiation results from our focus on product development from components to subsystem integration to overall system solution design.

Leading Solution for Emerging IP-based Networks. Our IP-based wireless backhaul solutions provide fiber-like performance with high throughput speeds of 50 to 900 megabits per second, high availability and low latency. Our solutions enable wireless service providers to transition to IP-based networks. Our suite of IP-based wireless backhaul products and hybrid network products is currently deployed in hundreds of private networks around the world. These solutions were the first of their kind to receive certification from Metro Ethernet Forum, a leading industry alliance of telecommunications service providers and other industry participants that develops technical specifications to promote the adoption of IP-based networks.

Broad Product Portfolio. We offer a broad range of high capacity wireless backhaul solutions, enabling us to offer complete solutions for the specific needs of a wide range of customers, based on service type, frequency, distance and capacity requirements. In addition to our circuit-switched and IP-based products, we also offer hybrid solutions that deliver both circuit-switched and IP traffic over a single radio. This functionality makes them particularly attractive for wireless service providers preparing to upgrade to an IP-based backhaul network.

Low Total Cost of Ownership. Our solutions address industry requirements for low total cost of ownership backhaul solutions. Total cost of ownership includes the combined costs of initial acquisition, installation and ongoing operation and maintenance, regardless of whether these costs are incurred through leasing arrangements or operating owned equipment.

Scalability and Flexibility. We design our products to enable incremental deployment to meet increased service demand. This enables wireless service providers to rapidly deploy additional capacity as it is needed. This approach allows our customers to establish a wireless broadband network with a relatively low initial investment and later expand the geographic coverage area of their networks as subscriber demand increases.

Our Products

We market all of our products under the trademark FibeAir®. These products utilize microwave radio technologies that enable our customers to optimize range and frequency efficiency, which we refer to as the modulation scheme, and to dynamically adapt to weather conditions. The diverse FibeAir® product family offers products that address the complete backhaul needs of IP-based, hybrid and circuit-switched networks:

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| Network Infrastructure | IP-based | | Hybrid | | | Circuit Switched | |
|------------------------|---|--|---|------------------------------------|--|--|---|
| | FibeAir IP-10/IP-MAX-G | FibeAir 3200T | FibeAir IP-10/IP-MAX-MS | FibeAir 640P | FibeAir 2000/4800 | FibeAir 1500P/1500R | FibeAir 3200T |
| Description | High-Capacity Ethernet | High-Capacity Circuit-switched Ethernet | High-Capacity Multi-Service | High-Capacity PDH Multi-Service | Unlicensed Multi-Service | High-Capacity SDH/SONET | High-Capacity Circuit-switched TDM |
| Interfaces | Gigabit Ethernet, Fast Ethernet | Multiple Gigabit Ethernet, Multiple Fast Ethernet | Gigabit Ethernet, multiple E1/T1, Fast Ethernet, multiple E1/T1 | Fast Ethernet, multiple E1/T1 | Fast Ethernet, multiple E1/T1 | STM-1/OC-3 | Multiple STM-1/OC-3 |
| Typical Applications | WiMAX backhaul, Metro area networks, Private networks | Metro area networks, Long distance networks | Wireless backhaul, Private networks | Wireless backhaul, Business access | Private Networks, Business access | Wireless backhaul, Metro area networks | Wireless backhaul, Long distance networks |
| Type of Customers | WiMax carriers, Wireless ISPs, Incumbent local exchange carriers, Businesses, Public institutions | Incumbent local exchange carriers, Public institutions | Wireless service providers, Incumbent local exchange carriers | Wireless service providers | Wireless ISPs, Businesses, Public institutions | Wireless service providers, Incumbent local exchange carriers, Public institutions | Wireless service providers, Incumbent local exchange carriers |

Our IP-based network products use native IP technologies and our hybrid products use our Native2 technologies which allow our hybrid products to transmit both IP-based and circuit-switched network traffic on a native basis. Native IP refers to systems that are designed to transport IP-based network traffic directly rather than adapting IP-based network traffic to existing circuit-switched systems. This approach increases efficiency and decreases latency.

Our products are typically sold as a complete system comprised of four components: an outdoor unit, an indoor unit, a compact high-performance antenna and a network management system.

Indoor units convert the transmission signals from digital to intermediate or radio frequency signals and vice versa, process and manage information transmitted to and from the outdoor unit, aggregate multiple transmission signals and provide a physical interface to wireline networks.

Outdoor units are used to control power transmission, convert intermediate frequency signals to radio frequency signals and vice versa, and provide an interface between antennas and indoor units. They are contained in compact weather-proof enclosures fastened to antennas. Indoor units are connected to outdoor units by standard coaxial cables.

Antennas are used to transmit and receive microwave radio signals from and to edge and core networks. These compact, high-performance devices are mounted on poles typically placed on rooftops, towers or buildings. We rely on third party vendors to supply this component.

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End-to-End Network Management. Our network management system uses simple network management protocol to monitor and control managed devices at both the element and network level and can be easily integrated into our customers' existing network management systems.

An antenna, an outdoor unit and an indoor unit comprise a terminal. Two terminals are required to form a radio link, which typically extends across a distance of several miles and can extend across a distance of 80 miles or more. The specific distance depends upon the customer's requirements and chosen modulation scheme, the frequency utilized, the available line of sight, local rain patterns and antenna size. Each link can be controlled by our network management system or can be interfaced to the network management system of the service provider. The systems are available in both split-mount, including an indoor and outdoor unit, and all-indoor installations.

Our Services

We are committed to providing high levels of service and implementation support to our customers. Our sales and network field engineering services personnel work closely with customers, system integrators and others to coordinate network design and ensure successful installation of our solutions. We are increasingly engaged in projects in which we provide the requisite installation, supervision and testing services, either directly or through subcontractors.

We support our products with documentation and training courses tailored to our customers' varied needs. We have the capability to remotely monitor the in-network performance of our products and to diagnose and address problems that may arise. We help our customers to integrate our network management system into their existing internal network operations control centers.

Our Customers

We have sold our products through a variety of channels to over 150 service providers and the operators of hundreds of private networks in nearly 100 countries. Our principal customers are wireless service providers that use our products to expand backhaul network capacity, reduce backhaul costs and support the provision of advanced telecommunications services. We reach a number of these customers through our OEM relationships. We also sell systems to large businesses and public institutions that operate their own private communications networks through system integrators, resellers and distributors. Our customer base is diverse in terms of both size and geographical location.

The following table summarizes the distribution of our revenues by region, stated as a percentage of total revenues for the year ended December 31, 2008, and the names of representative customers:

| Region | Year Ended December 31, 2008 | Representative Customers |
|--------------------------------|---------------------------------------|--|
| North America | 9% | AT&T, CellularOne, Connectronics, Hutton Communications, XO Communications |
| Europe, Middle East and Africa | 31% | Belgacom, Elro, KPN |
| Asia Pacific | 52% | Bharti Airtel, Digitel Mobile Philippines, IDEA Cellular, Reliance Communications, Tata Teleservices, Vodafone Essar |
| Latin America | 8% | Codetel, Telcel |

Sales and Marketing

We sell our products through a variety of channels, including direct sales, OEMs, distributors and system integrators. Our sales and marketing staff includes approximately 245 employees in 17 countries, who work together with local agents, distributors and OEMs to expand our sales.

We are a supplier to three OEMs, which together accounted for 33.7% of our revenues for the year ended December 31, 2008. The largest OEM is NSN, with whom we signed an OEM agreement as of November 2005 following several years of joint sales activities. For the year ended December 31, 2008, sales to NSN represented 24.2% of our revenues. We plan to increase our efforts in the development of additional strategic relationships with equipment vendors, integrators, networking companies and other industry suppliers with the goal of gaining greater

access to our target markets.

Our marketing efforts include advertising, public relations and participation in industry trade shows and conferences.

Manufacturing and Assembly

Our manufacturing process consists of materials planning and procurement, assembly of indoor units and outdoor units, final product assurance testing, quality control and packaging and shipping. With the goal of streamlining all manufacturing and assembly processes, we have implemented an outsourced, just-in-time manufacturing strategy that relies on contract manufacturers to manufacture and assemble circuit boards and other components used in our products and to assemble and test indoor units and outdoor units for us. The use of advanced supply chain techniques has enabled us to reduce our delivery time, while simultaneously increasing our manufacturing capacity and reducing our manufacturing costs.

We outsource the majority of our manufacturing operations to major contract manufacturers in Israel and the Philippines. Our warehouse operations are outsourced to a subcontractor in Israel. During the second half of 2006, we discontinued our manufacturing operations in Tel Aviv, Israel as part of the phase-out of our legacy FibeAir 1500 products. The raw materials for our products come primarily from the United States, Europe and Asia.

We comply with standards promulgated by the International Organization for Standardization and have received certification under the ISO 9001, ISO 9002, and ISO 14000 standards. These standards define the procedures required for the manufacture of products with predictable and stable performance and quality, as well as environmental guidelines for our operations.

Our activities in Europe require that we comply with European Union Directives with respect to product quality assurance standards and environmental standards. On July 1, 2006, the new RoHS (Restrictions of Hazardous Substances) Directive took effect, a development which required us to modify some of our products. In addition, the WEEE (Waste Electrical and Electronic Equipment) Directive requires producers of electrical and electronic equipment to register in different European countries and to provide collection and recycling facilities for used products.

Research and Development

We place considerable emphasis on research and development to improve and expand the capabilities of our existing products, to develop new products, with particular emphasis on equipment for emerging IP-based networks, and to lower the cost of producing both existing and future products. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we maintain close relationships with our customers to identify market needs and to define appropriate product specifications. In addition, we intend to continue to comply with industry standards and, in order to participate in the formulation of European standards, we are full members of the European Telecommunications Standards Institute.

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Our research and development activities are conducted at our facilities in Tel Aviv, Israel. As of December 31, 2008, our research, development and engineering staff consisted of 127 employees. Our research and development team includes highly specialized engineers and technicians with expertise in the fields of millimeter wave design, modem and signal processing, data communications, system management and networking solutions.

Our research and development department provides us with the ability to design and develop most of the aspects of our proprietary solutions, from the chip-level, including both application specific integrated circuits, or ASICs, and radio frequency integrated circuits, or RFICs, to full system integration. We leverage our research and development capabilities through the use of specialized outside design firms. Our research and development projects currently in process include improvements to our existing SONET/SDH products, extensions to our emerging IP-based networking product lines and development of new technologies to support future product concepts. In addition, our engineers continually work to redesign our products with the goal of improving their manufacturability and testability while reducing costs.

Intellectual Property

To safeguard our proprietary technology, we rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality agreements and other contractual arrangements with our customers, third-party distributors, consultants and employees, each of which affords only limited protection. We have a policy which requires all of our employees to execute employment agreements which contain confidentiality provisions.

We have registered trademarks as follows:

for the standard character mark Ceragon Networks and our logo in the United States, Israel, and the European Union;

for the standard character mark Ceragon Networks in Canada;

for our design mark for FibeAir in the United States, Israel and the European Union;

for the standard character mark FibeAir in the United States;

for the standard character mark CeraView in the United States, Israel and the European Union; and

For the standard character mark Native² in the European Union and in Australia.

Until recently, we have not aggressively pursued patent protection and consequently, our patent portfolio may not be as extensive as those of our competitors. As a result, we may have limited ability to assert any patent rights in negotiations with, or in counterclaiming against, competitors who assert intellectual property rights against us. To date, we have filed one non-provisional patent application and six provisional patent applications to protect our proprietary intellectual property in the areas of high capacity data transmission and adaptive modulation radios with native IP and native circuit-switch capabilities. We cannot assure you that any patents will actually be issued or that the scope of any issued patent will adequately protect our intellectual property rights.

Competition

The market for wireless equipment is rapidly evolving, fragmented, highly competitive and subject to rapid technological change. We expect competition to persist, intensify and increase in the future, especially if rapid technological developments occur in the broadband wireless equipment industry or in other competing high-speed access technologies.

We compete with a number of wireless equipment providers in the United States and other countries that vary in size and in the types of products and solutions they offer. Our primary competitors include Harris Stratex Networks, Inc., Huawei Technologies Co., Ltd., L.M. Ericsson Telephone Company, NEC Corporation (NEC) and Nokia Siemens Networks B.V. (NSN). In addition to these primary competitors, a number of other communications equipment suppliers, including Alcatel-Lucent, DragonWave Inc., Nera Networks AS, SIAE Microelectronica S.p.A. and ZTE Corporation, offer or are developing products that compete with our products.

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We believe we compete favorably on the basis of:

product performance, reliability and functionality;

range and maturity of product portfolio, including the ability to provide both circuit switch and IP solutions and therefore to provide a migration path for circuit-switched to IP-based networks;

cost; and

deployment, support and technical service and experience and commitment to high quality customer service.

Our products also indirectly compete with other high-speed communications solutions, including fiber optic lines and other wireless technologies.

Israeli Office of Chief Scientist

The Government of Israel encourages research and development projects through the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS, pursuant to the Law for the Encouragement of Industrial Research and Development, 1984, and the regulations promulgated thereunder, commonly referred to as the R&D Law.

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

In December 2006, we entered into an agreement with the OCS to conclude our R&D grant programs sponsored by the OCS. Under the agreement, we were required to repay the OCS approximately \$11.9 million in outstanding grants, in semiannual installments from 2007 through 2009. During the second quarter of 2008, we paid the OCS approximately \$7.4 million to retire all the debt remaining from this agreement. We entered into that agreement because we believed that the accelerating, interest-bearing royalty payments stemming from growth in our revenues significantly reduced the economic benefit of participation in such grants.

In June 2005, an amendment to the R&D Law came into effect, the intent of which was to make the R&D Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of OCS-funded know-how outside of Israel, as further described below. Even though we concluded our participation in the OCS grant program, these restrictions continue to apply to us.

The R&D Law generally requires that the product developed under a program be manufactured in Israel. However, upon the approval of the OCS, some of the manufacturing volume may be performed outside of Israel, provided that the grant recipient pays royalties at an increased rate, which may be substantial, and the aggregate repayment amount is increased up to 300% of the grant, depending on the portion of the total manufacturing volume that is performed outside of Israel. The 2005 amendment to the R&D Law further permits the OCS, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of the increased royalties.

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

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The R&D Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and foreign interested parties to notify the OCS of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the OCS to comply with the R&D Law. In addition, the rules of the OCS may require additional information or representations in respect of certain of such events. For this purpose, *control* is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. *Means of control* refers to voting rights or the right to appoint directors or the chief executive officer. An *interested party* of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 5% or more of our ordinary shares will be required to notify the OCS that it has become an interested party and to sign an undertaking to comply with the R&D Law.

C. Organizational Structure

We are an Israeli company that commenced operations in 1996. The following is a list of our significant subsidiaries:

| Company | Place of Incorporation | Ownership Interest |
|--------------------------------|------------------------|--------------------|
| Ceragon Networks (Aus) Pty Ltd | Australia | 100% |

| Company | Place of Incorporation | Ownership Interest |
|---|------------------------|--------------------|
| Ceragon Networks do Brasil Limitada | Brazil | 100% |
| Ceragon Networks (UK) Limited | England | 100% |
| Ceragon Networks SARL | France | 100% |
| Ceragon Networks (HK) Limited | Hong Kong | 100% |
| Ceragon Networks (India) Private Limited | India | 100% |
| Ceragon Networks, S.A. de C.V. | Mexico | 100% |
| Ceragon Networks, Inc. | New Jersey | 100% |
| Ceragon Networks (Nigeria) Limited | Nigeria | 100% |
| Ceragon Networks (Philippines), Inc. | Philippines | 100% |
| Ceragon Networks APAC (Singapore) Pte. Ltd. | Singapore | 100% |

D. Property, Plants and Equipment

Our corporate headquarters and principal administrative, finance, sales and marketing, R&D and operations departments are located at a leased facility of approximately 51,100 square feet in Tel Aviv, Israel. The leases for the majority of this space are valid until December 2010, with an option to renew for an additional two-year period.

In the United States, we lease approximately 5,800 square feet in Paramus, New Jersey, for our North American headquarters. The lease in Paramus is valid until July 2013. In the United Kingdom, we lease approximately 2,560 square feet in Birmingham expiring in March 2015. We also lease space for our local subsidiaries to conduct sales and marketing activities in their respective regions.

ITEM 4A UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements, the notes to those financial statements and other financial data that appear elsewhere in this annual report. In addition to historical information, the following discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in such forward-looking statements due to a number of factors, including those set forth in Risk Factors and elsewhere in this annual report. Our consolidated financial statements are prepared in conformity with U.S. GAAP.

Overview

We are a leading provider of high capacity wireless backhaul solutions that enable wireless service providers to deliver voice and premium data services, such as Internet browsing, music and video applications. Our backhaul solutions use microwave technologies to transfer large amounts of network traffic between base stations and the high capacity fiber-optic infrastructure at the core of the mobile network. We design our solutions to provide fiber-like connectivity for circuit-switched (SONET/SDH networks), next generation Ethernet/Internet Protocol (IP-based networks) and hybrid networks that combine circuit-switched and IP-based networks. Our solutions support all wireless access technologies including GSM, CDMA, EV-DO and WiMAX. These solutions address wireless service providers' need to cost-effectively build out and scale their infrastructure to meet the increasing demands placed on their networks by growing numbers of subscribers and the increasing demand for premium data services. We also provide our solutions to businesses and government agencies that operate their own private communications networks. Our solutions are deployed by more than 150 service providers of all sizes, as well as in hundreds of private networks, in nearly 100 countries.

We have grown our revenues from \$54.8 million for the year ended December 31, 2004 to \$217.3 million for the year ended December 31, 2008, representing a 41% compound annual growth rate, or CAGR. Our revenues for 2008 represent an increase of 34% compared to our

revenues for 2007. However, during the first quarter of 2009, due to the global economic crisis, our revenues are projected to be lower than those in the first quarter and last quarters of 2008. In 2008, approximately 31% of our revenues were derived from customers in Europe, the Middle East and Africa and 52% from customers in Asia Pacific.

Industry Trends

Market trends have placed, and will continue to place, pressure on the selling prices for our products and on our gross margins. The current global economic crisis has created significant challenges to our attempt to maintain or increase revenues. Our objective is to continue to meet the rising demand for our solutions while at the same time increasing our profitability. We seek to achieve this objective by constantly reviewing and improving our execution in, among others, development, manufacturing and sales and marketing. Set forth below is a more detailed discussion of the trends affecting our business:

Challenging Market Conditions. The current global economic crisis has resulted in a lengthening of the sales cycles and planned timeline for new customer projects and stretched our purchasing decisions. Consequently, revenue opportunities have diminished in the short term, and it will be a challenge to restore revenue growth to the rate experienced in the recent past.

Growing Number of Global Wireless Subscribers. Growth in the number of global wireless subscribers is being driven by the availability of inexpensive cellular phones and more affordable wireless service, particularly in developing countries and emerging markets, and is being addressed by expanding wireless networks and by building new networks.

Increasing Demand for Mobile Data Services. Wireless service providers are facing increasing demand from subscribers for mobile data services, including Internet browsing, music and video.

Transition to IP-based Networks. Wireless service providers are beginning to deploy all-IP networks and upgrade their infrastructure to interface with an IP-based core network in order to increase network efficiency, lower operating costs and more effectively deliver high-bandwidth data services.

We are also experiencing pressure on our sale prices as a result of several factors:

Increased Competition: Our target market is characterized by vigorous, worldwide competition for market share and rapid technological development. These factors have resulted in aggressive pricing practices and downward pricing pressures, and growing competition from both start-up companies and well-capitalized telecommunication systems providers.

Regional Pricing Pressures: In recent years we have increased sales of our products in India and other parts of Asia in response to the rapid build-out of cellular networks in those regions. For the years ended December 31, 2006, 2007 and 2008, 30%, 42% and 52%, respectively, of our revenues were earned in the Asia/Pacific region. Sales of our products in these markets are generally at lower gross margins in comparison to other regions.

Transaction Size: Competition for larger equipment orders is increasingly intense since the number of large equipment orders in any year is limited. Consequently, we generally experience greater pricing pressure when we compete for larger orders as a result of this increased competition and demand from purchasers for greater volume discounts. As an increasing portion of our revenues is derived from large orders, we believe that our business will be more susceptible to these pressures.

Sales through OEMs: Sales through our OEM relationships result in lower gross margins than sales directly to end-users through distributors and re-sellers. By selling our products to OEMs, we rely in part on the sales and marketing efforts of the OEMs, as well as on their post-sale support. For the year ended December 31, 2008, approximately 34% of our sales was to our three OEMs of wireless equipment, rather than directly to end users. We anticipate that sales to OEMs will become an increasing part of our business in the future.

Although we have successfully reduced the cost of producing our equipment and continue to focus on operational improvements, these price pressures may have a negative impact on our gross margins.

As we continue to expand our geographic footprint, we are increasingly engaged in supplying installation and other services for our customers, often in developing nations. In this context, we may act as prime contractor and equipment supplier for network build-out projects, providing installation, supervision and testing services required for these projects, or we may provide such services and equipment for projects handled by system integrators. In such cases, we typically bear the risks of loss and damage and title to our products until the customer has issued an acceptance certificate upon successful completion of acceptance tests. If our products are damaged or stolen, or if the network we install does not pass the acceptance tests, the end user or the system integrator, as the case may be, could refuse to pay us and we would incur substantial costs, including fees owed to our installation subcontractors, increased insurance premiums, transportation costs and expenses related to repairing or manufacturing the products. Moreover, in such a case, we may not be able to repossess the equipment, thus suffering additional losses.

Finally, although our revenues have grown rapidly over the last several years, we will not be able to sustain our recent growth rate in the short term due to the current economic crisis and may not be able to regain this rate of growth in future periods. You should not rely on our revenue growth in any prior quarterly or annual period as an indication of our future revenue growth.

Results of Operations

Revenues. We generate revenues primarily from the sale of our products, and, to a lesser extent, services. The final price to the customer may vary based on various factors, including but not limited to the size of a given transaction, the geographic location of the customer, the specific application for which products are sold, the channel through which products are sold, the competitive environment and the results of negotiation.

Cost of Revenues. Our cost of revenues consists primarily of the prices we pay contract manufacturers for the products they manufacture for us, component and material costs, labor costs, estimated warranty costs, costs related to management of our supply chain, shipping and, through the end of 2006, royalties to the Israeli Government in connection with grants we received from the OCS. In addition, we pay fees to subcontractors relating to installation services with respect to our products.

Operating Expenses

Research and Development Expenses. Our research and development expenses consist primarily of salaries and related costs for research and development personnel, subcontractors' costs, costs of materials and depreciation of equipment. All of our research and development costs are expensed as incurred. Through the end of 2006, research and development expenses were offset by grants from the OCS. We recognized such grants at the time we were entitled to them on the basis of the costs incurred and included these grants as a deduction from research and development expenses. We no longer intend to receive grants from the OCS. We believe continued investment in research and development is essential to attaining our strategic objectives.

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

General and Administrative Expenses. Our general and administrative expenses consist primarily of compensation and related costs for executive, finance and human resources personnel, professional fees (including legal and accounting fees), insurance, provisions for doubtful accounts and other general corporate expenses.

Financial Income, Net. Our financial income, net, consists primarily of interest earned on bank deposits and marketable securities, gains and losses arising from the remeasurement of transactions and balances denominated in non-dollar currencies into dollars, gains and losses from our currency hedging activity and fees and commissions paid to banks.

Taxes. Israeli companies are generally subject to corporate tax at the rate of 27% of their taxable income in 2008. The rate is scheduled to decline to 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 designated as set forth under the Law for the Encouragement of Capital Investments, 1959, or the Investment Law, may be considerably less. As of December 31, 2008, the end of our last fiscal year, our net operating loss carry forwards amounted to approximately \$45.7 million for Israeli tax purposes and \$9.7 million for U.S. tax purposes.

Critical Accounting Policies and Estimates

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

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

- Revenue recognition;
- Inventory valuation;
- Provision for doubtful accounts;
- Stock-based compensation expense;
- Deferred taxes; and
- Marketable securities.

Revenue recognition. We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition, which is commonly referred to as SAB 104, when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is probable. Generally, we do not grant a right of return to our customers. When a right of return exists, we create a provision for returns in accordance with Statement of Financial Accounting Standards No. 48, Revenue Recognition when Right of Return Exists.

When sale arrangements include a customer acceptance provision, revenue is recognized when we have demonstrated that the criteria specified in the acceptance provision have been satisfied. In arrangements which include multiple elements, we consider the sale of equipment and its installation to be two separate units of accounting in the arrangement in accordance with EITF 00-21, since the installation is not essential to the functionality of the equipment, the equipment has value to the customer on a standalone basis, and fair value of the installation services exists. In such arrangement, revenues from the sale of equipment are recognized upon delivery, if all other revenue recognition criteria are met, and we defer the fair value of the installation service (but not less than the amount contingent upon completion of installation, if any) to the period in which such installation occurs. Our typical product warranty is between 12 to 36 months at no extra charge. Factors that affect our warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. To assess the probability of collection for revenue recognition purposes, we analyze our historical collection experience, current economic trends and the financial position of our customers. On the basis of these criteria, we decide whether revenue recognition should be deferred and recognized on a cash basis. Deferred revenues include amounts received from customers for which revenue has not been recognized. We also apply Emerging Issues Task Force (EITF) 99-19, Reporting Revenues Gross as a Principal versus Net as an Agent (EITF 99-19), regarding arrangements where we also provide third party equipment and report revenues gross as a principal.

Inventory valuation. Our inventories are stated at the lower of cost or market value. Cost is determined by using the moving average cost method. At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes an analysis of slow-moving items and sales levels by product and projections of future demand. If needed, we write off inventories that are considered obsolete or excessive. If future demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of revenues in the period the revision is made.

Provision for doubtful accounts. We perform ongoing credit evaluations of our trade receivables and maintain an allowance for doubtful accounts, based upon our judgment as to our ability to collect outstanding receivables. Allowance for doubtful accounts is made based upon a specific review of all the outstanding invoices. In determining the provisions, we analyze our historical collection experience, current economic trends, the financial position of our customers and the payment guarantees (such as letters of credit) that we receive from our customers. In addition, we include a general provision for doubtful debts based on the age of the debts and on management's past experience in collecting such

receivables. We also insure certain trade receivables under credit insurance policies. If the financial condition of our customers deteriorates, resulting in their inability to make payments, additional allowances might be required. As of December 31, 2008, our allowance for doubtful accounts was \$2.5 million and our trade receivables were \$73.3 million. Historically, our provision for doubtful accounts has been sufficient to account for our bad debts.

Stock-based compensation expense. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, or SFAS 123(R), which requires the measurement and recognition of compensation expense based on estimated grant date fair values for all share-based payment awards made to employees and directors. For periods beginning in fiscal 2006, SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or APB 25, under which we previously accounted for our share based awards granted to employees and directors, for periods beginning in fiscal 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

SFAS 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 our consolidated income statement. Prior to the adoption of SFAS 123(R), we accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, or SFAS 123.

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We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard starting from January 1, 2006, the first day of our fiscal year 2006. Under that transition method, compensation cost recognized in 2006 included compensation cost for all share-based payments that were ultimately expected to vest (a) based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 for awards granted prior to, but not yet vested as of January 1, 2006, and (b) based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R) for awards granted subsequent to January 1, 2006. Results for prior periods have not been restated.

We selected the binomial option pricing model as the most appropriate fair value method for our share-option awards based on the market value of the underlying shares at the date of grant. We recognize compensation expenses for the value of our awards, which have graded vesting, based on the accelerated attribution method over the requisite service period, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures and on management's estimates. If actual forfeitures differ from our estimates, stock-based compensation expense and our results of operations would be impacted.

Stock-based compensation expense recognized under SFAS 123(R) was \$1.7 million, \$1.8 million and \$2.6 million for the years ended December 31, 2006, 2007 and 2008, respectively.

Deferred Taxes. We utilize the liability method of accounting for income taxes. We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Forming a conclusion that a valuation allowance is not required is difficult when there is negative evidence such as cumulative losses in the past. As a result of our cumulative losses and the utilization of our loss carryforward opportunities, we have recorded valuation allowances to reduce our net deferred tax assets to the amount we believe is more likely than not to be realized. While we have considered future taxable income and ongoing tax planning strategies in assessing the need for any valuation allowance, in the event we were to determine that we will be able to realize our deferred tax assets in the future in excess of the net recorded amount, an adjustment to the valuation allowance would increase income in the period such a determination is made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the valuation allowance would be charged to expenses in the period such a determination is made. During 2008, following our determination that it is more likely than not that we will be able to realize a portion of our deferred tax assets, we recorded a tax benefit of approximately \$11.4 million.

Marketable Securities. Based on our intention with respect to a particular investment at the time of investment, we are generally required to classify our investments under GAAP as held-to-maturity and to reevaluate this classification each reporting period. The classification of the investment may affect our reported results. For investments classified as held-to-maturity, we are required to carry the investment at amortized cost, with only the amortization occurring during the period recognized into income.

We periodically review our marketable securities for impairment. If we conclude that any of these investments are impaired, we determine whether such impairment is other-than-temporary as defined under FSP 115-1. Factors we consider to make such a determination include our intent and ability to hold the investment for a period of time sufficient for any anticipated recovery in market value, the length of time and extent to which the fair value has been less than its cost basis, the credit ratings of the securities, the nature of underlying collateral as applicable and

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the financial condition and near-term prospects of the issuer. If any impairment is considered other-than-temporary, we will write down the asset to its fair value and take a corresponding charge to our Consolidated Statements of Operations.

During 2008, we did not record other-than-temporary impairment of our marketable securities.

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Comparison of Period to Period Results of Operations

The following table presents consolidated statement of operations data for the periods indicated as a percentage of total revenues.

| | Year Ended December 31, | | |
|--|-------------------------|-------------|-------------|
| | 2006 | 2007 | 2008 |
| Revenues | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 74.5 | 63.9 | 66.6 |
| Gross profit | 25.5 | 36.1 | 33.4 |
| Operating expenses: | | | |
| Research and development | 12.3 | 9.5 | 9.3 |
| Less: Grants and participations | 1.4 | - | - |
| Research and development, net | 10.9 | 9.5 | 9.3 |
| Selling and marketing | 16.1 | 15.7 | 14.8 |
| General and administrative | 4.8 | 3.3 | 3.3 |
| Expense in respect of settlement reserve | - | 0.3 | - |
| Total operating expenses | 31.7 | 28.7 | 27.4 |
| Operating income (loss) | (6.2) | 7.4 | 6.0 |
| Financial income, net | 1.2 | 0.7 | 1.0 |
| Tax benefit, net | - | - | 5.0 |
| Net income (loss) | (5.0) | 8.1 | 12.0 |

Year ended December 31, 2007 compared to year ended December 31, 2008

Revenues. Revenues increased from \$161.9 million for the year ended December 31, 2007 to \$217.3 million for the year ended December 31, 2008, an increase of \$55.4 million, or 34%. This increase was attributable primarily to increased sales of our products to wireless service providers, in particular through our OEM channels, mainly within the Asia/Pacific region. Revenues in the Asia/Pacific region increased to \$113.0 million for the year ended December 31, 2008 as compared to \$68.4 million for the year ended December 31, 2007. The increase in revenues in the Asia/Pacific region was primarily due to deployment of new cellular networks and the related growth in the number of mobile subscribers in the region. As a percentage of revenues, sales in the Asia/Pacific region increased to 52% for the year ended December 31, 2008 from 42% for the year ended December 31, 2007.

Cost of Revenues. Cost of revenues increased from \$103.4 million for the year ended December 31, 2007 to \$144.6 million for the year ended December 31, 2008, an increase of \$41.2 million, or 40%. This increase was attributable to increased products purchased from our contract manufacturers in connection with our increased revenues, additional shipping costs that we incur primarily as part of the turnkey projects in which we are increasingly engaging and increased sales through our OEM channels that generate lower gross margin than our direct sales.

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Gross Profit. Gross profit as a percentage of revenues decreased from 36% for the year ended December 31, 2007 to 33% for the year ended December 31, 2008. The decrease resulted from:

Sales to OEMs which have increased from \$33.7 million for the year ended December 31, 2007 to \$73.1 million for the year ended December 31, 2008, an increase of \$39.4 million, or 117%. These sales generate lower gross margin than our direct sales.

Sales to customers in Asia Pacific, especially India, have increased. These sales have lower gross margin than sales in other regions.

Research and Development Expenses. Our research and development expenses increased from \$15.5 million for the year ended December 31, 2007 to \$20.3 million for the year ended December 31, 2008, an increase of \$4.8 million, or 31%. The increase in our research and development expenses was attributable primarily to the increase in salaries paid to our research personnel and related costs and increase of expenses paid to subcontractors. As a percentage of revenues, research and development expenses decreased to 9% in the year ended December 31, 2008 compared to 10% for the year ended December 31, 2007.

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Selling and Marketing Expenses. Selling and marketing expenses increased from \$25.3 million for the year ended December 31, 2007 to \$32.3 million for the year ended December 31, 2008, an increase of \$7.0 million, or 28%. This increase was attributable primarily to the salaries and related costs associated with hiring of additional personnel, an increase in commissions paid to our sales and marketing staff as a result of our increased sales in the aggregate amount of \$5.5 million, and an increase of \$1.5 million in office and other expenses that resulted in part from the opening of additional local sales offices. As a percentage of revenues, selling and marketing expenses were 15% in the year ended December 31, 2008 and 16% in the year ended December 31, 2007.

General and Administrative Expenses. General and administrative expenses increased from \$5.3 million for the year ended December 31, 2007 to \$7.2 million year ended December 31, 2008. This increase was attributable primarily to accruals made for doubtful debts in an aggregate amount of \$0.8 million and to an increase in expenses related to patent applications, opening new offices abroad and miscellaneous external services in the amount of \$0.5 million. As a percentage of revenues, general and administrative expenses were 3% in each of the years ended December 31, 2007 and 2008.

Settlement Reserve. On August 8, 2007, in response to NEC's assertion that we have been using its intellectual property in certain of our products, we made a settlement offer to NEC in order to fully resolve NEC's allegations. This settlement offer included a lump sum payment of \$0.45 million and certain cross-licensing arrangements in consideration for a release of any potential claim of infringement relating to NEC's allegations. As a result of this offer, we included a settlement reserve expense of \$0.45 million in the year ended December 31, 2007.

Financial Income, Net. Financial income, net increased from \$1.2 million for the year ended December 31, 2007 to \$2.2 million for the year ended December 31, 2008, an increase of \$1.0 million, or 83%. As a percentage of revenues, financial income, net increased to 1% in the year ended December 31, 2008 compared to 0.7% for the year ended December 31, 2007. Financial income rose because of the interest received on higher cash balances and cash investments following our offering in November 2007.

Tax Benefit, Net. For the year ended December 31, 2008, we recorded an income tax benefit, net of approximately \$10.8 million. The benefit was primarily derived from an increase in deferred income taxes assets reversing valuation allowances on deferred income tax assets of approximately \$11.4 million, offset in part by \$0.5 million of current taxes. As a percentage of revenues, tax benefit, net represent 5% in the year ended December 31, 2008 compared to none for the year ended December 31, 2007.

Net Income. Net income increased from \$13.1 million for the year ended December 31, 2007 to \$26.0 million for the year ended December 31, 2008. As a percentage of revenues, net income increased to 12% for the year ended December 31, 2008 from 8% for the year ended December 31, 2007.

Year ended December 31, 2006 compared to year ended December 31, 2007

Revenues. Revenues increased from \$108.4 million for the year ended December 31, 2006 to \$161.9 million for the year ended December 31, 2007, an increase of \$53.5 million, or 49%. This increase was attributable primarily to increased sales of our products to wireless service providers, in particular through our OEM channels, mainly within the Asia/Pacific region. Revenues in the Asia/Pacific region increased to \$68.4 million for the year ended December 31, 2007 as compared to \$32.4 million for the year ended December 31, 2006. The increase in revenues in the Asia/Pacific region was primarily due to deployment of new cellular networks and the related growth in the number of mobile subscribers in the region. As a percentage of revenues, sales in the Asia/Pacific region increased to 42% for the year ended December 31, 2007

from 30% for the year ended December 31, 2006.

Cost of Revenues. Cost of revenues increased from \$80.8 million for the year ended December 31, 2006 to \$103.4 million for the year ended December 31, 2007, an increase of \$22.6 million, or 28%. This increase was attributable to increased products purchased from our contract manufacturers in connection with our increased revenues, as well as additional shipping costs that we incur primarily as part of the turnkey projects in which we are increasingly engaging.

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Gross Profit. Gross profit as a percentage of revenues increased from 26% for the year ended December 31, 2006 to 36% for the year ended December 31, 2007. The increase resulted from:

execution of our cost reduction plan for our manufactured products;

the termination, pursuant to our agreement with the OCS, of our payments of royalties to the OCS equal to approximately 3% of our sales; and

a non-recurring expense in 2006 related to the termination of our participation in the OCS grant program.

These factors were partially offset by increased revenues from (i) sales to OEMs which have lower gross margin than our direct sales, (ii) sales to customers in certain Asian countries, especially India, which have lower gross margins than sales in other regions, and (iii) larger customer orders which typically involve volume discounts that result in lower gross margins.

Research and Development Expenses, Net. Our gross research and development expenses increased from \$13.3 million for the year ended December 31, 2006 to \$15.5 million for the year ended December 31, 2007, an increase of \$2.2 million, or 17%. The increase in our gross research and development expenses was attributable primarily to the increase in salaries paid to our research personnel and related costs. During the year ended December 31, 2006, \$1.5 million in research and development grants from the OCS were credited against our research and development expenses. During the year ended December 31, 2007, we did not receive any grants from the OCS. Our net research and development expenses thus increased from \$11.8 million for the year ended December 31, 2006 to \$15.5 million for the year ended December 31, 2007, an increase of \$3.7 million, or 31%. As a percentage of revenues, research and development expenses, net decreased to 10% in the year ended December 31, 2007 compared to 10.9% for the year ended December 31, 2006.

Selling and Marketing Expenses. Selling and marketing expenses increased from \$17.4 million for the year ended December 31, 2006 to \$25.3 million for the year ended December 31, 2007, an increase of \$7.9 million, or 45%. This increase was attributable primarily to the salaries and related costs associated with hiring of additional personnel and an increase in commissions paid to our sales and marketing staff as a result of our increased sales in the aggregate amount of \$4.4 million, an increase of \$ 1.5 million in travel expenses associated with higher sales and marketing activity and an increase of \$ 0.6 million in third party agent s commissions, especially in the Asia/Pacific region. As a percentage of revenues, selling and marketing expenses were 16% in each of the years ended December 31, 2006 and 2007.

General and Administrative Expenses. General and administrative expenses increased from \$5.2 million for the year ended December 31, 2006 to \$5.3 million year ended December 31, 2007. As a percentage of revenues, general and administrative expenses decreased to 3% in the year ended December 31, 2007 compared to 5% for the year ended December 31, 2006.

Settlement Reserve. On August 8, 2007, in response to NEC s assertion that we have been using its intellectual property in certain of our products, we made a settlement offer to NEC in order to fully resolve NEC s allegations. This settlement offer included a lump sum payment of \$0.45 million and certain cross-licensing arrangements in consideration for a release of any potential claim of infringement relating to NEC s allegations. As a result of this offer, we accrued a settlement reserve expense of \$0.45 million for the year ended December 31, 2007.

Financial Income, Net. Financial income, net decreased from \$1.3 million for the year ended December 31, 2006 to \$1.2 million for the year ended December 31, 2007, a decrease of \$0.1 million, or 8%. As a percentage of revenues, financial income, net decreased to 0.7% in the year ended December 31, 2007 compared to 1% for the year ended December 31, 2006.

Net Income (Loss). Our net income for the year ended December 31, 2007 was \$13.1 million as compared to a net loss for the year ended December 31, 2006 of \$5.5 million. The change from net loss in 2006 to net income in 2007 was attributable primarily to a non-recurring expense in 2006 related to the termination of our participation in the OCS grant program in the amount of \$10.4 million. As a percentage of revenues, net income was 8.1% for the year ended December 31, 2007.

Impact of Inflation and Currency Fluctuations

We typically derive the majority of our revenues in U.S. dollars. Although the majority of our revenues were denominated in U.S. dollars, a significant portion of our expenses were denominated in Israeli shekels and to a significantly lesser extent in Euros. 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. Transactions and balances in currencies other than U.S. dollars are remeasured into U.S. dollars according to the principles in Financial Accounting Standards Board Statement No. 52. Gains and losses arising from remeasurement are recorded as financial income or expense, as applicable.

The dollar cost of our operations is influenced by the extent that any inflation in Israel is or is not offset, or is offset on a lagging basis, by the devaluation of the NIS in relation to the dollar. A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of our expenses that are payable in NIS, unless those expenses or payables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of our unlinked NIS expenses. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our results.

The following table presents information about the rate of inflation in Israel and the exchange rate of the NIS against the dollar:

| Year ended December 31, | Israeli inflation rate % | NIS devaluation (appreciation) % |
|-------------------------|-----------------------------|-------------------------------------|
| 2004 | 1.2 | (1.6) |
| 2005 | 2.4 | 6.8 |
| 2006 | (0.1) | (8.2) |
| 2007 | 3.4 | (9.0) |
| 2008 | 3.8 | (1.1) |

Part of our revenues and expenses in Europe are received or incurred in Euros. We are exposed to the risk of an appreciation of the Euro if our expenses in Euros exceed our sales in Euros. In addition, if the Euro devaluates relative to the dollar and sales in Euros exceed expenses incurred in Euros, our operating profit may be negatively affected as a result of a decrease in the dollar value of our sales.

Since exchange rates between the NIS and the dollar, and between the Euro and the dollar, fluctuate continuously, exchange rate fluctuations would have an impact on our results and period-to-period comparisons of our results. We reduce this currency exposure by entering into hedging transactions. The effects of foreign currency re-measurements are reported in our consolidated financial statements of operations. For a discussion of our hedging transactions, please see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

Effects of Government Regulations and Location on the Company's Business

For a discussion of the effects of Israeli governmental regulation and our location in Israel on our business, see Information on the Company Business Overview Conditions in Israel in Item 4 and the Risks Relating to our Location in Israel in Item 3, above.

Liquidity and Capital Resources

Since our initial public offering in August 2000, we have financed our operations primarily through the proceeds of that initial public offering and a follow-on offering and through royalty-bearing grants from the OCS. In the initial public offering, we raised \$97.8 million; and through December 31, 2006, we received a total of \$18.5 million from the OCS. In a follow-on public offering completed in December 2007, we raised a net amount of \$88.3 million.

As of December 31, 2008, we had approximately \$97.8 million in cash and cash equivalents, short- and long-term bank deposits, and short- and long-term marketable securities.

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As of December 31, 2008, our cash investments were comprised of the following: 29% consisted of short-term, highly liquid investments with original maturities of up to three months, and 38% consisted of short-term deposits and marketable securities with original maturities of up to one year, with a minimum credit rating of A1/P1. The remaining balance of our liquid assets is invested in corporate debt securities and in bank deposits with maturities of up to three years, carrying a minimum rating of AA-/AA3. Substantially all of these investments are in US dollars.

Net cash used in operating activities was approximately \$11.5 million for the year ended December 31, 2008, \$4.3 million for the year ended December 31, 2007 and \$4.4 million for the year ended December 31, 2006. In 2008, our cash used in operating activities was affected by:

- a \$30.3 million increase in trade receivables, which was primarily attributable to our increased revenues;
- a \$11.4 million increase in a deferred income tax asset, which was attributable to the creation for the first time of the deferred tax asset.
- a \$3.4 million increase in inventories, which was primarily attributable to an increase in finished goods; and
- a \$5.3 million decrease in other accounts payable and accrued expenses, which was primarily attributable to the retirement of the remaining debt to the OCS from the agreement reached in December 2006 and, in addition, a \$4.7 million decrease in long term payables as a result of retiring such debt. The total payment to the OCS was in the amount of \$9 million.

These factors were partially offset by:

- our net income of \$26.0 million; and
- a \$13.9 million increase in trade payables, which was primarily attributable to growth in the volume of our sales and related purchases of products from our contract manufacturers.

In 2007, our cash used in operating activities was affected by:

- a \$13.1 million increase in trade receivables, which were primarily attributable to our increased revenues;
- a \$9.5 million increase in inventories, which was primarily attributable to an increase in finished goods;
- a \$3.7 million increase in other accounts receivables and prepaid expenses, which was primarily attributable to an increase in prepaid expenses mainly related to deferred revenues from turnkey projects; and
- a \$3.3 million decrease in other long-term payables as a result of two installment payments to the OCS pursuant to the termination of the OCS grant program.

These factors were partially offset by:

- our net income of \$13.1 million;
- a \$4.2 million increase in trade payables, which was primarily attributable to growth in the volume of our sales and related purchases of products from our contract manufacturers;
- a \$2.4 million increase in other accounts payable and accrued expenses, which was primarily attributable to employee accruals; and
- a \$3.0 million increase in deferred revenues, which were primarily attributable to increased advance payments from customers received as a result of our increasing participation in turnkey projects.

In 2006, our cash used in operating activities was affected by:

- our net loss of \$5.5 million;
- a \$12.4 million increase in trade receivables which was primarily attributable to our increased revenues; and
- a \$11.2 million increase in inventories which was primarily attributable to an increase in finished goods.

These factors were partially offset by:

- a \$9.8 million increase in trade payables which was primarily attributable to growth in the volume of our sales and related purchases of products from our contract manufacturers; and
- a \$7.9 million increase in long-term payables attributable to our termination of the OCS grant program.

Net cash used in investing activities was approximately \$11.3 million for the year ended December 31, 2008, as compared to net cash used in investing activities of approximately \$45.9 million for the year ended December 31, 2007 and net cash provided by investing activities of approximately \$2.1 million for the year ended December 31, 2006. In the year ended December 31, 2008, our investments of \$66.3 million in short-term and long-term bank deposits and \$14.9 million in held to maturity marketable securities were partially offset by the proceeds of \$13.5 million from held-to-maturity marketable securities and proceeds of \$61.4 million from maturity of short- and long-term bank deposits. In addition, there was a purchase of property and equipment in a net amount of \$5 million. In the year ended December 31, 2007, the proceeds of \$8.6 million from held-to-maturity marketable securities and proceeds of \$6.2 million from maturity of short- and long-term bank deposits were offset by our investments of \$35.7 million in short-term and long-term bank deposits and \$22.2 million in held to maturity marketable securities. These investments were attributable to the proceeds from the follow-on public offering completed in November 2007. In addition, there was a purchase of property and equipment in a net amount of \$2.9 million. In the year ended December 31, 2006, our cash generated from investing activities resulted from \$3.6 million in proceeds from maturities of short-term and long-term bank deposits and \$5.5 million in proceeds from held-to-maturity marketable securities which were partially offset by investments in short-term and long-term bank deposits in the amount of \$2.5 million, investments in held-to-maturity marketable securities in the amount of \$3.1 million and the purchase of property and equipment in the amount of \$1.4 million.

Net cash used in financing activities was approximately \$7.6 million for the year ended December 31, 2008 as compared to net cash provided by financing activities of \$98.7 million for the year ended December 31, 2007 and net cash provided by financing activities of \$2.1 million for the year ended December 31, 2006. For the year ended December 31, 2008, the Company used an amount of \$7.9 million to purchase treasury shares as part of the Company's share repurchase program. For the year ended December 31, 2007, a net amount of \$88.7 million consisted of the net proceeds of the issuance of shares in a follow-on public offering. The balance of the cash as of December 31, 2007 and 2006 consisted of proceeds from exercises of share options by employees.

As of December 31, 2008, our principal commitments consisted of \$7.9 million for obligations outstanding under non-cancelable operating leases.

In October 2008, we announced the adoption a share repurchase program under which under which the total amount to be paid for the repurchase of shares would not exceed \$20 million. As of December 31, 2008, we had purchased 1,499,803 shares at a weighted average price per share of approximately \$5.28 per share.

Our capital requirements are dependent on many factors, including working capital requirements to finance the growth of the Company, the level of our gross profit and the allocation of resources to our research and development efforts, as well as our marketing and sales activities. We anticipate that our capital expenditures during 2009 will be primarily for the purchase of testing equipment and office equipment.

We believe that current cash and cash equivalent balances, short-term bank deposits and short-term marketable securities will be sufficient for our requirements through at least the next 12 months.

Research and Development

We place considerable emphasis on research and development to improve and expand the capabilities of our existing products, to develop new products, with particular emphasis on equipment for emerging IP-based networks, and to lower the cost of producing both existing and future products. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we maintain close relationships with our customers to identify market needs and to define appropriate product specifications. In addition, we intend to continue to comply with industry standards and, in order to participate in the formulation of European standards, we are full members of the European Telecommunications Standards Institute.

Our research and development activities are conducted at our facilities in Tel Aviv, Israel. As of December 31, 2008, our research, development and engineering staff consisted of 127 employees. Our research and development team includes highly specialized engineers and technicians with expertise in the fields of millimeter wave design, modem and signal processing, data communications, system management and networking solutions.

Our research and development department provides us with the ability to design and develop most of the aspects of our proprietary solutions, from the chip-level, including both ASICs and RFICs, to full system integration. We leverage our research and development capabilities through the use of specialized outside design firms. Our research and development projects currently in process include improvements to our existing SONET/SDH products, extensions to our emerging IP-based networking product lines and development of new technologies to support future product concepts. In addition, our engineers continually work to redesign our products with the goal of improving their manufacturability and testability while reducing costs.

Intellectual Property

See: Item 4. History and Development of the Company Intellectual Property.

Off Balance Sheet Arrangements

We are not 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 liabilities.

Tabular Disclosure of Contractual Obligations

| <i>Contractual obligations</i> | Payments due by period (in thousands of dollars) | | | | |
|--|--|------------------|-----------|-----------|-------------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years | More than 5 years |
| Operating lease obligations ¹ | 7,874 | 2,829 | 3,728 | 1,041 | 276 |
| Purchase obligations ² | 35,305 | 35,305 | - | - | - |
| Other long-term commitment ³ | 2,582 | - | - | - | 2,582 |
| Total | 45,761 | 38,134 | 3,728 | 1,041 | 2,858 |

(1) Consists of operating leases for our facilities and for vehicles.

(2) Consists of all outstanding purchase orders for our products from our suppliers.

(3) Our obligation for accrued severance pay under Israel's Severance Pay Law as of December 31, 2008 was approximately \$6.6 million, of which approximately \$4.1 million was funded through deposits in severance pay funds, leaving a net obligation of approximately \$2.6 million.

New Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (Revised) *Business Combinations*. SFAS 141 (Revised) replaces SFAS 141 *Business Combinations* and 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 noncontrolling 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 statements to evaluate the nature and financial effects of the business combination. The guidance will become effective for the fiscal year beginning after December 15, 2008. We do not expect that SFAS 141 (Revised) will have any impact on our historical financial statements upon adoption.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS 160 amends Accounting Research Bulletin 51, *Consolidated Financial Statements*, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect that SFAS 160 will have any impact on our historical financial statements upon adoption.

In February 2008, the FASB issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP 140-3). FSP 140-3 concludes that a transferor and transferee should not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. FSP 140-3 is effective for financial statements issued for fiscal years beginning on or after November 15, 2008, and interim periods within those fiscal years. The adoption of FSP 140-3 is not expected to have a material effect on the Company's results of operations or financial position.

In February 2008, the FASB issued FSP No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*", and FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*". Collectively, the Staff Positions defer the effective date of Statement 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of Statement 157.

In March 2008, the FASB issued Statement 161 *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161), an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. We do not expect the adoption of SFAS 161 will have a material impact on our consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 became effective in November 2008. The adoption of this statement is not expected to have a material effect on our financial statements.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table lists our current directors and senior management:

| Name | Age | Position |
|----------------|------------|--|
| Zohar Zisapel | 60 | Chairman of the Board of Directors |
| Ira Palti | 51 | President and Chief Executive Officer |
| Naftali Idan | 57 | Executive Vice President and Chief Financial Officer |
| Hillik Rave | 57 | Executive Vice President, Worldwide Operations |
| Eran Westman | 38 | Executive Vice President, Worldwide Sales |
| Sharon Ganot | 40 | Vice President, Human Resources |
| Udi Gordon | 42 | Vice President, Business Development |
| Norman Kotler | 57 | General Counsel and Corporate Secretary |
| Aviv Ronai | 40 | Chief Marketing Officer |
| Hagai Zys | 37 | Vice President, Research and Development |
| Joseph Atsmon | 60 | Director |
| Yael Langer | 44 | Director |
| Yair E. Orgler | 69 | Director |
| Avi Patir | 60 | Director |

Zohar Zisapel has served as the Chairman of our board of directors since we were incorporated in 1996. Mr. Zisapel is also a founder and a director of RAD Data Communications Ltd., of which he served as CEO from January 1982 until January 1998 and has served as chairman since 1998. Mr. Zisapel serves as chairman of two other public companies RADVision Ltd. and RADCOM Ltd. and as chairman or director of several private companies. Since July 2008, Mr. Zisapel has been a director of Amdocs Limited, a public company. Mr. Zisapel previously served as head of the electronics research and development department in the Israeli Ministry of Defense. Mr. Zisapel received a B.Sc. and an M.Sc. in electrical engineering from the Technion, Israel Institute of Technology and an M.B.A. from Tel Aviv University.

Ira Palti has been our President and Chief Executive Officer since August 2005. From January 2003 to August 2005, Mr. Palti was Chief Executive Officer of Seabridge Ltd., a Siemens company that is a global leader in the area of broadband services and networks. Prior to joining Seabridge, he was the Chief Operating Officer of VocalTec Communications Ltd., responsible for sales, marketing, customer support and product development. Among the positions he held before joining VocalTec was founder of Rosh Intelligent Systems, a company providing software maintenance and AI diagnostic solutions and one of the first startups in Israel. Mr. Palti received a B.Sc. in mathematics and computer science (magna cum laude) from Tel Aviv University.

Naftali Idan has served as our Executive Vice President and Chief Financial Officer since August 2004. Prior to joining Ceragon, Mr. Idan was Senior Vice President, Chief Financial Officer at Floware Wireless Systems Ltd. from 2000 to 2001. From 1993 to 1999, he was the Executive Vice President and Chief Financial Officer of Tecnomatix Technologies Ltd. Prior to joining Tecnomatix, Mr. Idan was with Optrotech Ltd. from 1985 to 1992, where he held several positions in finance, the last one being Vice President, Finance & Administration of its US subsidiary. Prior to that, Mr. Idan served in various financial roles in both US and Israeli firms. Mr. Idan received a B.A. in accounting and economics from Tel Aviv University and an M.B.A. from De Paul University in Chicago, and is a certified public accountant in Israel.

Hillik Rave has served as our Executive Vice President, Worldwide Operations since December 2005. Prior to joining the Company, Mr. Rave served as Vice President of Operations & Engineering at ECI Telecom Ltd. in its Optical Networks Division from 2000 to 2005. From 1996 to 2000 he served as Associate Vice President Commercial at ECI Telecom. Prior to joining ECI Telecom, he held management positions at Telrad, Rabintex, Scitex and ATA from 1985 to 1996. Mr. Rave received a B.A. in industrial engineering and an M.B.A. in business and industrial management from Ben-Gurion University.

Eran Westman has served as our Executive Vice President, Worldwide Sales since October 2008. From January 2004 to September 2008, Mr. Westman served as President Asia Pacific, and from July 2001 to December 2003, he was Vice President Sales for Europe, the Middle East and Africa. Prior to joining Ceragon, Mr. Westman served from 1991 to 1996 in the electronic research and development department of the Israeli Ministry of Defense. Mr. Westman holds a LL.B degree from the Herzog Faculty of Law at Bar Ilan University.

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Sharon Ganot has served as our Vice President, Human Resources since March 2000. From December 1999 until March 2000, Ms. Ganot was the manager of our human resources department. From April 1994 until December 1999, she was a personnel recruiter and training manager with RAD Data Communications Ltd. Ms. Ganot received a B.A. in psychology and an M.A. in industrial studies from Tel Aviv University.

Udi Gordon has served as our Vice President, Business Development since October 2008. From 2003 to 2008, Mr. Gordon headed our research and development department, his most recent position being Executive Vice President R&D. From 1997 until June 2003, he served as a senior manager in our research and development department. From 1990 until 1997, Mr. Gordon served in the electronic research and development department in the Israeli Ministry of Defense. Mr. Gordon received a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology (cum laude) and an M.B.A. from Bar-Ilan University.

Norman Kotler has served as our General Counsel and Corporate Secretary since August 2004. Prior to joining Ceragon, Mr. Kotler was General Counsel and Corporate Secretary at Sapiens International Corporation (2003-2004) and Aprion Digital Ltd. (2001-2003). From 1989 to 2001, Mr. Kotler was the chief legal advisor at ECI Telecom Ltd., his last position there being Associate Vice President, Legal Affairs and Corporate Secretary. Before joining ECI Telecom, Mr. Kotler was associated with law firms in Israel and in Phoenix, Arizona. Mr. Kotler received a J.D. from University of Arizona, an M.A. in history from University of Toronto and a B.A. in history (summa cum laude) from York University (Toronto).

Aviv Ronai has served as our Chief Marketing Officer since October 2006. From January 1998 to October 2006, Mr. Ronai held several senior marketing positions at ECI Telecom Ltd., the last one being Vice President of Marketing and Communications. From 1991 to 1997 he served in the Israeli Air Force as a telecommunication officer and project manager. Mr. Ronai received a B.Sc. in electrical and electronics engineering and an M.B.A. from Tel-Aviv University.

Hagai Zyss has served as our Vice President, Research and Development since October 2008. Previously, Mr. Zyss served in our research and development from June 2000, his most recent position being Vice President Next Generation Networks. Prior to joining Ceragon, Mr. Zyss served from 1993 to 2000 in the electronic research and development department of the Israeli Ministry of Defense. Mr. Zyss received B.Sc. and M.Sc. degrees (cum laude) in electrical engineering and electronics from Tel-Aviv University.

Joseph Atsmon has served as a director since July 2001. Mr. Atsmon has also served as a director of Nice Systems Ltd. since July 2001 and of RADVision Ltd. since June 2003. From November 2005 until December 2008, Mr. Atsmon was a director of VocalTec Communications Ltd.. From April 2001 until October 2002, he served as Chairman of Discretix Ltd. From 1995 until 2000, he served as Chief Executive Officer of Teledata Communications Ltd., a public company acquired by ADC Telecommunications Inc. in 1998. From 1986 until 1995, Mr. Atsmon served in various positions at Tadiran Ltd., among them a division president and Corporate Vice President for business development. Mr. Atsmon received a B.Sc. in electrical engineering (summa cum laude) from the Technion, Israel Institute of Technology. Mr. Atsmon is one of our independent directors for the purposes of the Nasdaq Marketplace Rules (the Nasdaq Rules) and is our audit committee chairman and financial expert.

Yael Langer has served as a director since December 2000. Ms. Langer served as our general counsel from July 1998 until December 2000. Ms. Langer is General Counsel and Secretary of RAD Data Communications Ltd. and other companies in the RAD-BYNET group. From December 1995 to July 1998, Ms. Langer served as Assistant General Counsel to companies in the RAD-BYNET group. From September 1993 until July 1995, Ms. Langer was a member of the legal department of Poalim Capital Markets and Investments Ltd. Ms. Langer received an LL.B. from the Hebrew University in Jerusalem.

Yair E. Orgler has served as a director since March 2007. Prof. Orgler is Professor Emeritus at the Leon Recanati Graduate School of Business Administration, Tel Aviv University (the Recanati School). From 1996 to June 2006, Prof. Orgler was Chairman of the Board of the Tel-Aviv Stock Exchange. From 2001 to 2004, he was President of the International Options Markets Association (IOMA). Prof. Orgler serves as a director at Bank Hapoalim, B.M., Israel Chemicals Ltd., Atidim-High Tech Industrial Park Ltd., ICL-IP Co. Ltd., ICL-IP Ltd., Itamar Medical Ltd. and Gazit-Globe Ltd. Other public positions held by Prof. Orgler in recent years include: Founder and Chairman of Maalot , Israel's first securities rating company; Chairman of the Wage Committee of the Association of University Heads in Israel; Chairman of the Executive Council of the Academic College of Tel-Aviv-Yaffo; and member of the Board of the United States-Israel Educational Foundation (USIEF). Previous academic positions held by Prof. Orgler include: Vice Rector of Tel-Aviv University and before that Dean of the Recanati School. For over 20 years he was the incumbent of the Goldreich Chair in International Banking at Tel-Aviv University and served frequently as a Visiting Professor of Finance at the Kellogg Graduate School of Management, Northwestern University. Prof. Orgler holds a Ph.D. and Master's degree in business administration from Carnegie Mellon University, an M.Sc. in industrial engineering from University of Southern California and a B.Sc. in industrial engineering from the Technion. Prof. Orgler is one of our independent directors for the purposes of the Nasdaq Rules and one of our external directors for purposes of the Companies Law.

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Avi Patir has served as a director since March 2007. Mr. Patir is President for Mobile Broadband (WiMAX) at MIRS Communications Ltd., a wholly-owned subsidiary of Motorola Israel Ltd. From 2004 to 2006, Mr. Patir served as the Group COO and Head of the Wireline Division of Bezeq The Israel Telecommunication Corp. Limited (Bezeq), Israel's national telecommunications provider. From 2003 to 2004, Mr. Patir was President and CEO of American Israel Paper Mills Ltd., the leading Israeli manufacturer and marketer of paper and paper products. From 1996 to 2003, he was the President and CEO of Barak International Telecommunication Corporation Ltd., a leading provider of international telecommunications services in Israel, and from 1992 to 1996, he was Executive Vice President Engineering and Operations at Bezeq. Prior to that, Mr. Patir served for many years in the Israeli Defense Forces, retiring as a full Colonel. Mr. Patir has been a board member of, among others, Bezeq International, Pelephone Communications Ltd. and Satlink Communications Ltd. Mr. Patir holds an M.Sc. in electrical and electronic engineering from Columbia University and a B.Sc. in electrical and electronic engineering from the Technion. He is, in addition, a graduate of the Kellogg-Recanati executive management program. Mr. Patir is one of our independent directors for the purposes of the Nasdaq Rules and one of our external directors for purposes of the Companies Law.

Compensation of Directors and Senior Management

The following table presents all compensation we paid to all of our directors and senior management as a group for the year ended December 31, 2008. The table does not include any amounts we paid to reimburse any of such persons for costs incurred in providing us with services during this period.

| | Salaries, fees, commissions and bonuses | Pension, retirement and other similar benefits |
|--|---|---|
| All directors and senior management as a group, consisting of 14 persons | \$ 2,362,397 | \$ 274,726 |

During 2008, we granted to our directors and senior management 400,000 options to purchase ordinary shares, in the aggregate, with exercise prices of \$5.10 and \$9.09 per share. The options expire 10 years after grant.

Other than payment of fees to our external directors as required by the Companies Law, reimbursement for expenses and the award of stock options, we do not compensate our directors for serving on our board of directors. For more information, please see Remuneration of Directors and The 2003 Share Option Plan below and Note 9 to our Consolidated Financial Statements included as Item 18 in this annual report.

Board Practices

Our Articles of Association authorize our board of directors to consist of a minimum of five and a maximum of nine members. Our board of directors presently consists of five members. The board retains all the powers in running our company that are not specifically granted to the shareholders. The board may make decisions to borrow money for our company, and may set aside reserves out of our profits, for whatever purposes it thinks fit.

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The board may pass a resolution when a quorum is present, and each resolution must be passed by a vote of at least a majority of the directors present when the resolution is put to vote and voting thereon. According to our Articles of Association, unless otherwise unanimously decided by our board of directors, a quorum of directors is at least a majority of the directors then in office (but not less than two directors). Our board of directors may elect one director to serve as the chairman of the board to preside at the meetings of the board of directors, and may also remove such director as chairman. Minutes of the meetings are recorded and kept at our offices.

Terms of Directors

Our Articles of Association provide that directors, other than our external directors described below, are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented at that meeting and voting thereon. In accordance with the provisions of the Companies Law, each of our external directors, as further described below, serves a three-year term, which may be extended by additional three-year terms. At the annual general meeting of shareholders in September 2004, our Articles of Association were amended to provide for a classified board of directors. The board of directors is presently divided into two classes: Class I and Class II. Each director (other than an external director), when and however elected, will be designated as a member of one of the two classes of directors. The director (other than a director elected to fill a vacancy as permitted under our Articles of Association) will serve for a term ending on the date of the third annual general meeting following the annual general meeting at which such director was elected. Ms. Langer is currently our Class I

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director, serving for a term ending at the 2011 annual general meeting. Messrs. Zisapel and Atsmon are currently our Class II directors, serving for a term ending at the 2009 annual general meeting of the shareholders.

If any directors are appointed by the board of directors to fill any vacancy, their appointment must be ratified by the shareholders at the next shareholders meeting following the appointment. Our shareholders may remove a director from office, in certain circumstances subject to the Companies Law. There is no requirement that a director own shares of our company. Directors may appoint alternative directors in their stead, provided that an external director may appoint an alternate director only for a committee of the board of directors on which the appointing external director serves, and provided further that the alternate director so appointed is an external director who has either accounting and financial expertise or professional qualifications in accordance to the qualification of the appointing external director and that such alternate director does not already serve as a member of that committee.

According to an amendment to the Companies Law adopted in 2008, a person who does not possess the skills required and the ability to devote the appropriate time to the performance of the office of director in a company, taking into consideration, among other things, the special requirements and size of that company, shall neither be appointed as director nor shall serve as director in a public company. A public company shall not summon a general assembly whose agenda includes the appointment of a director, and a director shall not be appointed, unless the candidate has submitted a declaration that he or she possesses the skills required and the ability to devote the appropriate time to the performance of the office of director in the company, that sets forth the aforementioned skills and that states that the limitations set forth in the Companies Law regarding the appointment of a director do not apply in respect of such candidate.

A director who ceases to possess any qualification required under the Companies Law for holding the office of director or who becomes subject to any ground for termination of his/her office must inform the company immediately and his/her office shall terminate on such notice.

As a company organized in Israel whose ordinary shares are listed for quotation on the Nasdaq Global Market, we are required to comply with the rules of the SEC and the Nasdaq Rules applicable to listed companies, as well as with the Companies Law, which is applicable to all Israeli companies. Under the Nasdaq Rules, a majority of our directors is required to be independent and, under the Israeli Companies Law, we are required to appoint at least two external directors. According to an amendment to the Companies Law adopted in 2008, a public company may provide in its articles that independent directors (as defined in the Companies Law) in such minimal number as shall be determined by the company shall serve in its board of directors. According to the Companies Law, an independent director is a director who meets the qualifications required for the appointment of such director as an external director in the company, other than the requirement for possession of accounting and financial expertise or professional qualifications, as shall be approved by audit committee, and who has not served as a director on the board of directors of the company for more than nine consecutive years. We did not amend our articles of association to provide for the appointment of independent directors according to the Companies Law.

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Independent Directors

The independence standard under the Nasdaq Rules excludes, among others, any person who is a current or former (at any time during the past three years) employee of a company or its affiliates as well as the immediate family members of an executive officer (at any time during the past three years) of a company or its affiliates. Messrs. Joseph Atsmon, Yair Orgler and Avi Patir currently serve as our independent directors.

External Directors

Under the Companies Law, companies incorporated under the laws of Israel whose shares have been offered to the public in or outside of Israel are required to appoint at least two external directors. A person may not be appointed as an external director if he or she or his or her relative, partner, employer, any person to whom such person is directly or indirectly subject to, or any entity under his or her control has, as of the date of the person's appointment to serve as an external director, or had, during the two years preceding that date, any affiliation with:

the company;

any entity controlling the company at the date of such person's appointment; or

any entity controlled, at the date of such person's appointment or during the two years preceding that date, by the company or by its controlling shareholder.

The term "affiliation" includes:

an employment relationship;

a business or professional relationship maintained on a regular basis;

control; and

service as an office holder.

The Companies Law defines the term "office holder" of a company to include a director, the chief executive officer, the chief business manager, a vice general manager, deputy general manager and any officer that reports directly to the chief executive officer or any other person fulfilling any of the foregoing positions (even if such person's title is different).

According to regulations promulgated under the Companies Law:

A public company may appoint an external director to serve as director in its wholly owned and controlled subsidiaries, subject to certain conditions;

A person who served as an external director in a target company which was merged into the acquiring company shall not be deemed to have an affiliation with the acquiring company;

A person who had an affiliation with a corporation (other than the public company or other corporation under its control) which is under the control of the controlling shareholder of a public company, only in such period in which such controlling shareholder was not the controlling shareholder of the public company, shall not be deemed to have an affiliation during the two years period preceding the date of appointment;

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A business or professional relationship shall not be deemed as an affiliation if all of the following conditions are met: (i) the relationship is negligible for both the person who is the nominee to be appointed as an external director and the company; (ii) the relationship commenced prior to such person's appointment; (iii) the audit committee resolved, prior to the appointment, based on facts presented to it, that the condition detailed in clause (i) is fulfilled; and (iv) the existence of a business or professional relationship and the approval of the audit committee were brought to the attention of the shareholders meeting prior to the approval of the appointment.

An external director who ceases to possess any qualification required under the Companies Law for holding the office of an external director must inform the company immediately and his/her office shall terminate upon such notice.

Yair Orgler and Avi Patir were appointed in 2006 as our external directors. Their terms began in March 2007 and will expire in March 2010.

Pursuant to an amendment to the Companies Law, (1) each external director must have either "accounting and financial expertise" or "professional qualifications" and (2) at least one of the external directors must have "accounting and financial expertise".

A director with "accounting and financial expertise" is a director whose education, experience and qualifications qualifies him or her to be highly proficient in understanding business and accounting matters and to thoroughly understand the company's financial statements and to stimulate discussion regarding the manner in which financial data is presented. A director with "professional qualifications" must either (i) have an academic degree in economics, business management, accounting, law, public administration or other academic degree or high education in the company's main field of business or which is relevant to his or her office; or (ii) have at least five years' experience in one or more of the following: senior position in the business management of a corporation with substantial business activities, senior public servant, or other seniority in the company's main fields of business.

Our board of directors has determined that Prof. Orgler has the "accounting and financial expertise" required by the Companies Law, and that Mr. Patir has the required "professional qualifications".

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

A director in a public company shall not be appointed as an external director in another public company if at the time of appointment a person who serves as a director of the other public company also serves as an external director of the first public company.

A company may not engage an external director as an office holder and may not employ or receive services from that person for consideration, either directly or indirectly, including through a corporation controlled by that person, for a period of two years from the termination of his or her service as an external director.

Election of External Directors

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

at least one third of the shares of non-controlling shareholders voted at the meeting, not taking into account any abstentions, vote in favor of the election; or

the total number of shares voted against the election of the external director does not exceed one percent of the aggregate voting rights in the company.

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The initial term of an external director is three years with respect to a company such as ours may be extended for additional three-year terms by the shareholders, if certain conditions are met. An external director can be removed from office only by the same majority of shareholders that is required to elect an external director, or by a court (if the external 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 external director, except for the audit committee, which is required to include all external directors.

In a company in which, at the date of appointment of an external director, all the directors are of the same gender, the external director to be appointed shall be of the other gender.

Audit Committee

Nasdaq Requirements

Under the Nasdaq Rules, we are required to have an audit committee consisting of at least three independent directors, all of whom are financially literate and one of whom has been determined by the board to be the audit committee financial expert. We have adopted an audit committee charter as required by the Nasdaq Rules. The responsibilities of the audit committee under the Nasdaq Rules include evaluating the independence of a company's outside auditors. Currently, Messrs. Joseph Atsmon, Yair Orgler and Avi Patir serve on our audit committee, each of whom has been determined by the board to be independent. Mr. Atsmon is the chairman of the audit committee and its financial expert.

The Nasdaq Rules require that director nominees be selected or recommended for the board's selection either by a nominations committee composed solely of independent directors or by a majority of independent directors, subject to certain exceptions. Similarly, the compensation payable to a company's chief executive officer and other executive officers must be approved either by a majority of the independent directors on the board or a compensation committee comprised solely of independent directors, subject to certain exceptions. In July 2005, our board of directors determined that the independent directors would carry out these functions.

Companies Law Requirements

Under the Companies Law, the board of directors of any Israeli company whose shares are publicly traded must appoint an audit committee, comprised of at least three directors including all of the external directors, but excluding:

the chairman of the board of directors;

any controlling shareholder or any relative of a controlling shareholder; and

any director employed by the company or who provides services to the company on a regular basis.

The role of our audit committee is to identify irregularities in the management of our business, in consultation with the internal auditor our independent auditors, and to suggest appropriate courses of action to amend such irregularities. In addition, the approval of our audit committee is required under the Companies Law to effect certain related-party transactions.

The composition of our audit committee satisfies both the Nasdaq Rules and the Companies Law requirements.

Approval of Certain Transactions

The approval of the audit committee is required (and thereafter, the approval of the board of directors and in certain cases the approval of the shareholders), under the Companies Law to effect specified actions and extraordinary transactions with office holders, third parties (where an office holder has a personal interest in the transaction), extraordinary transactions with controlling parties, and extraordinary transactions with a third party (where a controlling party has a personal interest in the transaction), including a private placement in which the controlling shareholder has a personal interest, or any transaction with the controlling shareholder or his relative regarding terms of service and employment. A relative is defined in the Companies Law as spouse, sibling, parent, grandparent, descendant, spouse's descendant and the spouse of any of the foregoing.

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In addition, the approval of the audit committee is required (and thereafter, the approval of the board of directors and of the shareholders, in that order) under the Companies Law, to effect a private placement of securities, in which either (i) 20% or more of the company's outstanding share capital prior to the placement are offered, and the payment for which (in whole or in part) is not in cash, in tradable securities registered in a stock exchange or not under market terms, and which will result in an increase of the holdings of a shareholder that holds 5% or more of the company's outstanding share capital or voting rights or will cause any person to become, as a result of the issuance, a holder of more than 5% of the company's outstanding share capital or voting rights or (ii) a person will become a controlling shareholder of the company.

A controlling party is defined in the Companies Law for purposes of the provisions governing related party transactions as a person with the ability to direct the actions of a company, or a person who holds 25% or more of the voting power in a public company if no other shareholder owns more than 50% of the voting power in the company, but excluding a person whose power derives solely from his or her position as a director of the company or any other position with the company, provided that two or more persons holding voting rights in the company, who each have a personal interest in the approval of the same transaction, shall be deemed to be one holder.

The audit committee may not approve an action or an extraordinary transaction discussed above unless at the time of approval the two external directors are serving as members of the audit committee and at least one of them is present at the meeting in which an approval was granted.

Audit committee approval is also required (and thereafter, the approval of the board of directors and in certain cases the approval of the shareholders) to approve the grant of an exemption from the responsibility for a breach of the duty of care towards the company, or for the provision of insurance or an undertaking to indemnify any office holder of the company. In addition, any contract between the company and any of its directors relating to the service or employment of the director must be approved by the audit committee, the board of directors and, unless certain conditions specified by regulations promulgated under the Companies Law are met, the shareholders, in such order.

Remuneration of Directors

Directors' remuneration requires the approval of the audit committee, the board of directors and the shareholders (in that order). However, according to regulations promulgated under the Companies Law with respect to the remuneration of external directors, the audit committee and shareholder's approval may be waived if the remuneration to be paid to the external directors is in the exact amounts set forth in the regulations.

According to the regulations promulgated under the Companies Law concerning the remuneration of external directors (the Remuneration Regulations), external directors are generally entitled to an annual fee, a participation fee for each meeting of the board of directors or any committee of the board on which he or she serves as a member and reimbursement of travel expenses for participation in a meeting which is held outside of the external director's place of residence. The minimum, fixed and maximum amounts of the annual and participation fees are set forth in the Remuneration Regulations, based on the classification of the company according to the amount of its capital. According to the

Remuneration Regulations, the audit committee and shareholder's approval may be waived if the annual and participation fees to be paid to the external directors are within the range of the fixed annual fee or the fixed participation fee and the maximum annual fee or the maximum participation fee for the company's level, respectively. However, remuneration of an external director in an amount which less than the fixed annual fee or the fixed participation fee, respectively, requires the approval of the audit committee, the board of directors and the shareholders (in that order). The remuneration of external directors must be made known to the candidate for such office prior to his/her appointment and, subject to certain exceptions, will not be amended throughout the three-year period during which he or she is in office. A company may compensate an external director in shares or rights to purchase shares, other than convertible debentures which may be converted into shares, in addition to the annual remuneration, the participation award and the reimbursement of expenses, subject to certain limitations set forth in the External Directors Remuneration Regulations. We pay our external directors a fixed annual fee, a fixed participation fee and reimbursement of expenses. In addition we have granted our external directors options to purchase the Company's shares.

Additionally, according to other regulations promulgated under the Companies Law, shareholders' approval for directors' compensation and employment arrangements is not required if both the audit committee and the board of directors resolve that either (i) the directors' compensation and employment arrangements are solely for the benefit of the company or (ii) the remuneration to be paid to any such director does not exceed the maximum amounts set forth in the regulations promulgated under the Companies Law regarding remuneration of external directors; provided however that no holder of 1% or more of the issued and outstanding share capital or voting rights in the company objects to such exemption from the shareholders' approval requirement such objection to be submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution by the company pursuant to the requirements of the Israeli Securities Law). If such objection is duly and timely submitted, then the remuneration arrangement of the directors will require shareholders' approval as detailed above.

Neither we nor any of our subsidiaries has entered into a service contract with any of our current directors that provide for benefits upon termination of their service as directors.

Option Committee

Our option committee administers our 1996 Key Employee Share Incentive Plan, our 1997 Affiliate Employee Option Plan and our 2003 Share Option Plan. The members of the option committee are Messrs. Zisapel and Patir. The board of directors has delegated to the option committee the authority to grant options under the 1996, 1997 and 2003 option plans, and to act as the share incentive committee pursuant to those plans, provided that such grants are within the framework determined by the board.

Dividends

Dividends may be paid only out of accumulated retained earnings, as defined in the Companies Law, as of the end of the most recent fiscal period or as accrued over a period of two years, whichever is higher, and out of surplus derived from net profit and other surplus that is neither share capital nor premium, all as determined under the Companies Law (the Profit Test), in each case provided that there is no reasonable concern that payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. Notwithstanding the foregoing, dividends may be paid with the approval of a court even if the Profit Test is not met, provided that there is no reasonable concern that payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. Dividends may be paid in cash, assets, shares or debentures. For further information, please see Financial Information Dividends.

Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor proposed by the audit committee. The role of the internal auditor is to examine, among other things, whether the company's conduct complies with applicable law, integrity and orderly business procedure. The internal auditor has the right to request that the chairman of the audit committee convene an audit committee meeting, and the internal auditor may participate in all audit committee meetings. Under the Companies Law, the internal auditor may be an employee of the company but may not be an interested party, an office holder or a relative of the foregoing, nor may the internal auditor be the company's independent accountant or its representative. The Companies Law defines the term interested party to include a person who holds 5% or more of the company's outstanding share capital or voting rights, a person who has the right to appoint one or more directors or the general manager, or any person who serves as a director or as the general manager.

We have appointed the firm of Chaikin, Cohen, Rubin & Co., Certified Public Accountants (Isr.) as our internal auditor.

Fiduciary Duties of Office Holders

The Companies Law imposes a duty of care and a duty of loyalty on all office holders of a company, including directors and officers. The duty of care requires an office holder to act with the level of care with which a reasonable office holder in the same position would have acted under the same circumstances. The duty of care includes a duty to use reasonable means to obtain:

information regarding the advisability of a given action submitted for his or her approval or performed by him or her by virtue of his or her position; and

all other important information pertaining to these actions.

The duty of loyalty of an office holder is a duty to act in good faith and for the benefit of the company, and includes a duty to:

refrain from any conflict of interest between the performance of his or her duties in the company and any other of his or her other duties or his or her personal affairs;

refrain from any activity that is competitive with the company;

refrain from exploiting any business opportunity of the company to receive a personal gain for himself or herself or others; and

disclose to the company any information or documents relating to a company's affairs which the office holder has received due to his or her position as an office holder.

The company may approve an action by an office holder from which the office holder would otherwise have to refrain due to its violation of the office holder's duty of loyalty (as described above) if:

the office holder acts in good faith and the act or its approval does not cause harm to the company; and

the office holder discloses the nature of his or her interest in the transaction to the company in a reasonable time before the company's approval.

Each person listed in the table under **Directors and Senior Management** above is considered an office holder under the Companies Law.

Disclosure of Personal Interests of an Office Holder

The Companies Law requires that an office holder of a company disclose to the company, promptly, and, in any event, not later than the first board meeting at which the transaction is discussed, any direct or indirect personal interest that he or she may have and all related material information and documents known to him or her relating to any existing or proposed transaction by the company. If the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by:

the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of these people; or

any corporation in which the office holder is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

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

other than in the ordinary course of business;

otherwise than on market terms; or

that is likely to have a material impact on the company's profitability, assets or liabilities.

The Companies Law does not specify to whom within the company nor the manner in which required disclosures are to be made. We require our office holders to make such disclosures to our board of directors.

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

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

Disclosure of Personal Interests of a Controlling Shareholder

Under the Companies Law, the disclosure requirements which apply to an office holder also apply to a controlling shareholder of a public company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, including a private placement in which the controlling shareholder has a personal interest, and the engagement of a controlling shareholder or a relative as an office holder or employee, require the approval of the audit committee, the board of directors and the majority of the voting power of the shareholders present and voting at the general meeting of the company (not including abstentions), provided that either:

at least one-third of the shares of shareholders who have no personal interest in the transaction and who are present and voting (in person or by proxy or written ballot), vote in favor; or

shareholders who have no personal interest in the transaction who vote against the transaction do not represent more than one percent of the aggregate voting rights in the company.

With respect to the aforementioned transaction, any shareholder participating in the vote must inform the company prior to the voting whether or not he or she has a personal interest in the approval of the transaction, and if he or she fails to do so, his or her vote will be disregarded.

In accordance with regulations promulgated under the Companies Law, certain extraordinary transactions between a public company and its controlling shareholder(s) do not require shareholders' approval, subject to the existence of one of the following circumstances, which existence was approved by the audit committee and then by the board of directors, such circumstances exist when a contemplated transaction: (i) may involve the extension of an existing transaction that was duly approved in accordance with the provisions of the Companies Law and does not involve any significant change in the terms of the existing transaction and other related circumstances or the change is solely for the benefit of the company; (ii) is solely for the benefit of the company; (iii) is with the controlling shareholder or another person in which the controlling shareholder has an interest and the transaction is in accordance with the terms of a framework transaction that was duly approved under the provisions of the Companies Law, such framework transaction allowing the company to execute transactions, in the ordinary course of business, of similar type, period and such other terms detailed in the framework transaction; (iv) is with the controlling shareholder or another person in which the controlling shareholder has an interest, the purpose of which is a transaction with a third party or a joint proposal to enter into a transaction with a third party, and the terms of the transaction that apply to the company are not materially different from the terms that apply to the controlling shareholder or an entity controlled by him or her (while taking into account the extent of their respective involvement in the transaction); or (v) is among companies under the common control of a controlling shareholder, or between a public company and the controlling shareholder or another person in which the controlling shareholder has a personal interest, and the transaction is on market terms, within the ordinary course of business and does not harm the company. Additionally, employment and compensation arrangements for an office holder that is a controlling shareholder in a public company and the purchase of an insurance policy for such controlling shareholder or his relative do not require shareholders' approval if certain criteria are met, as approved by the audit committee and the board of directors. The foregoing exemptions from shareholders' approval will not apply if one or more shareholders holding at least 1% of the issued and outstanding share capital of a public company or of such company's voting rights, objects to the use of these exemptions provided that such objection is submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution

by the company pursuant to the requirements of the Israeli Securities Law. If such objection is duly and timely submitted, then the transaction or compensation arrangement of the directors will require shareholders' approval as detailed above.

In addition, under the Companies Law, each shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations toward the company and other shareholders and to refrain from abusing his power in the company, such as shareholder votes. Further, specified shareholders have a duty of fairness toward the company. These shareholders include any controlling shareholder, any shareholder who knows that he or she possesses the power to determine the outcome of a shareholders' vote, and any shareholder who, pursuant to the provisions of the Articles of Association, has the power to appoint or to prevent the appointment of an office holder or any other power toward the company. However, the Companies Law does not define the substance of this duty of fairness.

Exculpation, Insurance and Indemnification of Directors and Officers

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

Office Holders' Insurance

Our Articles of Association provide that, subject to the provisions of the Companies Law, we may enter into a contract for the insurance of the liability of any of our office holders concerning an act performed by him or her in his or her capacity as an office holder for:

a breach of his or her duty of care to us or to another person;

a breach of his or her duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice our interests; or

a financial liability imposed upon him or her in favor of another person.

Exculpation and Indemnification of Office Holders

Our Articles of Association provide that, subject to the provisions of the Companies Law, we may indemnify any of our office holders against an act performed in his or her capacity as an office holder, including indemnity for the following:

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

reasonable litigation expenses, including attorneys' fees, expended by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against him and either (i) concluded without the imposition of any financial liability in lieu of criminal proceedings or (ii) concluded with the imposition of a financial liability in lieu of criminal proceedings but relates to a criminal offense that does not require proof of criminal intent; and

reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him or her by a court, resulting from the following: proceedings we institute against him or her or instituted on our behalf or by another person; a criminal indictment from which he or she was acquitted; or a criminal indictment in which he or she was convicted for a criminal

offense that does not require proof of intent.

Limitations on Insurance and Indemnification

The Companies Law provides that a company may not exculpate or indemnify an office holder nor enter into an insurance contract which would provide coverage for any monetary liability incurred as a result of any of the following:

a breach by the office holder of his or her duty of loyalty, except that the company may enter into an insurance contract or indemnify an office holder if the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;

a breach by the office holder of his or her duty of care if the breach was done intentionally or recklessly, unless it was committed only negligently;

any act or omission done with the intent to derive an illegal personal benefit; or

any fine levied against the office holder.

In addition, under the Companies Law, exculpation and indemnification of, and procurement of insurance coverage for, our office holders must be approved by our audit committee and our board of directors and, with respect to an office holder who is also a controlling shareholder or a director, also by our shareholders (unless the exemptions discussed above apply).

We indemnify our office holders to the fullest extent permitted under the Companies Law. We currently hold directors and officers liability insurance for the benefit of our office holders. This policy was approved by our board of directors and by our shareholders. Insofar as indemnification for liabilities arising under the United States Securities Act of 1933, as amended, may be permitted to our directors, officers and controlling persons, we have been advised that, in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

Mergers and Acquisitions under Israeli Law

The Companies Law includes provisions that allow a merger transaction and requires that each company that is a party to the merger have the transaction approved by its board of directors and a vote of the majority of its shares. However, with respect to companies such as Ceragon, which were incorporated prior to the Companies Law coming into effect, shareholders' approval must be obtained by holders of at least 75% of the shares participating at the shareholders' meeting and voting thereon, not taking into account any abstentions. In accordance to the Companies Law, a shareholders' meeting may resolve that a lower majority will be required for the approval of a merger, provided that such resolution is approved by holders of at least 75% of the shares participating at the shareholders' meeting and voting thereon, not taking into account any abstentions.

The board of directors of any merging company contemplating whether to approve a merger must determine, in light of the financial condition of the merging companies, whether in its opinion 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. If such reasonable concern exists, the board of directors will not authorize the merger.

For purposes of the shareholders' vote of each party, the merger will not be deemed approved if shares, representing a majority of the voting power present at the shareholders' meeting and which are not held by the other party to the merger (or by any person who holds 25% or more of the voting power or the right to appoint 25% or more of the directors of the other party), vote against the merger (the dissenting shares). If a person holds at least 25% of the voting shares or 25% of the rights to appoint directors in both merging companies, the aforementioned limitation shall apply with respect to both merging companies. If the transaction would have been approved but for the objection of the dissenting shares, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the valuation of each of the parties to the merger and the consideration offered to the shareholders.

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. In addition, a merger may not be completed unless at least (i) 50 days have passed from the time that the requisite proposals for approval of the merger were filed with the Israeli Registrar of Companies by each merging company and (ii) 30 days have passed since the merger was approved by the shareholders of each merging company.

A merger is not subject to shareholders' approval (i) of the target company if such target company is a wholly-owned subsidiary of the acquiring company; (ii) of the acquiring company if (a) the merger does not involve an amendment to the acquiring company's articles of association or memorandum of association, and (b) the acquiring company does not issue within the framework of the merger more than 20% of voting rights (for that matter only any securities held by such person which may be converted or exercised into shares shall be deemed to be converted or exercised, as applicable), and no person will become, as a result of any issuance of securities in the acquiring company within the framework of the merger, a controlling shareholder, and (c) if no circumstances which enable the dissenting shareholders to deny approval of the merger (as detailed above) exist.

If the target company shares are divided into more than one class of shares, the merger is also conditioned upon approval by the shareholders participating in all such class meetings. Notwithstanding the lack of such approval by all such class meetings, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the valuation of each of the parties to the merger and the consideration offered to the shareholders.

Special Tender Offer. The Companies Law also 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 25% or more of the voting power in the company. This rule does not apply if there is already another holder of 25% or more of the voting power 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 45% or more of the voting power in the company, unless there is already a holder of 45% or more of the voting power in the company. These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received shareholders' approval (including approval of the purchaser becoming a holder of 25% or more, or 45% or more, of the voting power in the company, unless there is already a holder of 25% or more or 45% or more, respectively, of the voting power in the company), (2) was from a holder of 25% or more of the voting power in the company which resulted in the acquirer becoming a holder of 25% or more of the voting power in the company, or (3) was from a holder of 45% or more of the voting power in the company which resulted in the acquirer becoming a holder of 45% or more of the voting power in the company. The tender offer must be extended to all shareholders, but the offeror is not required to purchase more than 5% of the company's outstanding shares, regardless of how many shares are tendered by shareholders. The tender offer may be consummated only if (i) at least 5% of the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

Full Tender Offer. The Companies Law also provides that if, as a result of an acquisition of shares, the acquirer will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to the acquirer. The Companies Law provides for appraisal rights if any shareholder who was an offeree in the tender offer files a request in court within three months following the consummation of a full tender offer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares. Shares acquired in violation of these provisions become dormant and cease to confer any rights upon their holder as long as the shares are held by the acquirer.

Regular Tender Offer. According to regulations promulgated under the Israeli Securities Law, an action of an offeror which is intended to persuade the public to sell to the offeror securities, including securities which may be converted or exercised into shares of a public company, constituting more than 5% of such registered securities, within any 6 month period, but excluding the acquisition of such securities on a stock exchange, must be made by a way of a tender offer directed to all such securities holders on equal terms.

Any tender offer must be made by a written document and meet specific requirements set forth in the regulations promulgated under the Israeli Securities Law. However, such regulations set forth that, with respect to a tender offer which is subject to, in addition the Israeli regulations, the law of a foreign state, including the rules and guidelines applicable to an exchange on which such company's shares are registered for trade, the tender offer may be exempt from any provision of the regulations if the chairman of the Israeli Securities Authority concludes that such provision may be detrimental to the tender offer and the waiver of such provision will not be detrimental to a reasonable offeree.

Israel tax law treats share-for-share acquisitions between an Israeli company and another company less favorably than does U.S. tax law. For example, Israeli tax law may, under certain circumstances, subject a shareholder who exchanges his or her ordinary shares for shares in another corporation to taxation prior to the sale of the shares received for such share-for-share swap.

Employees

As of December 31, 2008, we had 444 employees worldwide, of whom 127 were employed in research, development and engineering, 245 in sales and marketing, 35 in management and administration and 37 in operations. Of these employees, 265 were based in Israel, 24 were based in the United States, 19 were based in Europe, 20 were based in Latin America and 116 were based in Asia-Pacific.

As of December 31, 2007, we had 334 employees worldwide, of whom 118 were employed in research, development and engineering, 142 in sales and marketing, 33 in management and administration and 41 in operations. Of these employees, 251 were based in Israel, 19 were based in the United States, 13 were based in Europe, 15 were based in Latin America and 36 were based in Asia-Pacific.

As of December 31, 2006, we had 304 employees worldwide, of whom 108 were employed in research, development and engineering, 132 in sales and marketing, 28 in management and administration and 36 in operations. Of these employees, 220 were based in Israel, 20 were based in the United States, 14 were based in Europe, 16 were based in Latin America and 34 were based in Asia-Pacific.

We and our employees are not parties to any collective bargaining agreements. However, with respect to our Israeli employees, we are subject to Israeli labor laws, regulations and collective bargaining agreements between the Histadrut, the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialists Association, by extension orders of the Israeli Ministry of Labor and Welfare, as are in effect from time to time with respect to our Israeli employees. These laws and regulations principally concern matters such as paid annual vacation, paid sick days, length of the workday and work week, minimum wages, payment for overtime, payment during reserve duty, insurance for work-related accidents, severance payments and other conditions of employment. Generally, we provide our employees with benefits and working conditions above the legally required minimums.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination without due cause. We currently fund a partial amount of the severance obligations by making monthly payments in the amount of 8.33% of an employee's monthly wages to approved pension funds or insurance policies.

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Furthermore, we and our employees are required to make payments to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Such amounts also include payments by the employee for mandatory health insurance. The total payments to the National Insurance Institute are equal to approximately 17.43% of an employee's salary (up to a maximum amount), of which the employee contributes approximately 12.00% and the employer contributes approximately 5.43% of the salary.

Substantially all of our employment agreements include employees' undertakings with respect to non-competition, assignment to us of intellectual property rights developed in the course of employment and confidentiality. However, it should be noted that the enforceability of non-competition undertakings is rather limited under Israeli law.

Our employees are covered by a managers insurance fund, which provides life and pension insurance coverage with customary benefits to employees, including retirement and severance benefits. We contribute 13.33% of the employee's base salary (which includes a severance amount) to managers insurance fund and the employees contribute 5.00% of their base salary to such funds. In addition, our employees are entitled to an advanced education fund. We contribute 7.50% of the employees' base salary and the employees contribute 2.50% of their base salary to such fund.

Our employees are not represented by a labor union. To date, we have not experienced labor-related work stoppages and believe that our relations with our employees are good.

The employees of our subsidiaries are subject to local labor laws and regulations that vary from country to country.

Share Ownership

The following table sets forth certain information regarding the ordinary shares owned, and stock options held, by our directors and senior management as of March 15, 2009. The percentage of outstanding ordinary shares is based on ordinary shares outstanding as of March 15, 2009.

| Name | Number of Ordinary Shares | Percentage of Outstanding Ordinary Shares | Number of Stock Options Held ⁽¹⁾ | Range of exercise prices per share of stock options |
|------|---------------------------|---|---|---|
|------|---------------------------|---|---|---|

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| Name | Number of Ordinary Shares | Percentage of Outstanding Ordinary Shares | Number of Stock Options Held ⁽¹⁾ | Range of exercise prices per share of stock options |
|--|---------------------------|---|---|---|
| Zohar Zisapel | 4,101,559 | 12.0 | 390,000 | \$2.00 - \$11.75 |
| Ira Palti | - | - | 1,045,000 | \$4.49 - \$9.09 |
| All directors and senior management as a group, consisting of 14 people ⁽²⁾ | 4,101,559 | 12.0 | 2,750,250 | \$1.50 - \$11.75 |

- (1) Each stock option is exercisable into one ordinary share, and expires 10 years from the date of its grant.
- (2) Each of the directors and senior managers other than Messrs. Zohar Zisapel and Ira Palti beneficially owns less than 1% of the outstanding ordinary shares as of March 15, 2009 (including options held by each such person and which are vested or shall become vested within 60 days of March 15, 2009) and have therefore not been separately disclosed.

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Stock Option Plans

1996 Key Employee Share Incentive Plan

In August 1996, we adopted our key employee share incentive plan. We ceased granting options under this plan as of December 31, 2002 in light of the adoption of our 2003 share option plan and a change in applicable Israeli tax laws, although options granted under this plan before December 31, 2002 are still valid subject to the plan. Employees of our company and our subsidiaries or affiliates belonging to the RAD-BYNET group were eligible to participate in the plan. The options expire five to ten years from the date of grant. The following table presents option grant information for this plan as of December 31, 2008:

| Ordinary shares reserved for option grants | Options outstanding | Weighted average exercise price |
|--|---------------------|---------------------------------|
| 387,200 | 387,200 | \$6.54 |

Affiliate Employees Option Plan

In May 1997, we adopted our affiliate employees option plan. We ceased granting options under this plan as of February 2003 in light of the adoption of our 2003 share option plan and a change in applicable Israeli tax laws, although options granted under this plan before February 2003 are still valid subject to the plan. This plan has terms that are substantially identical to the terms of the 1996 key employee share incentive plan. The options expire five to ten years from the date of grant. The following table presents option grant information for this plan as of December 31, 2008:

| Ordinary shares reserved for option grants | Options outstanding | Weighted average exercise price |
|--|---------------------|---------------------------------|
| 339,208 | 339,208 | \$4.21 |

In September 2003, our shareholders approved the transfer of all unissued shares previously reserved by our shareholders for option grants for which no options were granted under the 1996 key employee share incentive plan and the affiliate employees plan for grants pursuant to the 2003 share option plan.

The 2003 Share Option Plan

In September 2003, our shareholders approved and adopted our 2003 share option plan. This plan complies with changes in Israeli tax law that were introduced in 2003 with respect to share options. The plan is designed to grant options pursuant to Section 102 or 3(i) of the Israeli Tax Ordinance (New Version), 1961. It is also intended to be a "qualified plan" as defined by U.S. tax law. Our worldwide employees, directors, consultants and contractors are eligible to participate in this plan. The option committee of our board of directors administers the plan. Generally, the options expire ten years from the date of grant. The option committee has an authority to include in the notice of grant a provision regarding the acceleration of the vesting period of any option granted upon the occurrence of certain events. In addition, our board of directors has sole discretion to determine, in the event of a transaction with other corporation, as defined in the plan, that each option shall either: (i) be substituted for an option to purchase securities of the other corporation; (ii) be assumed by the other corporation; or (iii) automatically vest in full. In the event that all or substantially all of the issued and outstanding share capital of the company shall be sold, each option holder shall be obligated to participate in the sale and to sell his/her options at the price equal to that of any other share sold. This plan has been approved by the Israeli Tax Authority as is required by applicable law. The following table presents option grant information for this plan as of December 31, 2008.

| Cumulative Ordinary Shares Reserved for Option Grants | Remaining Reserved Shares Available for Option Grants | Options Outstanding | Weighted Average Exercise Price |
|--|--|----------------------------|--|
| 13,546,780 | 338,482 | 4,666,093 | \$ 5.39 |

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The following table presents certain option grant information concerning the distribution of options (granted under all three plans of the Company) among directors and employees of the Company as of December 31, 2008:

| | Options Outstanding | Unvested Options |
|---------------------------------|----------------------------|-------------------------|
| Directors and senior management | 2,510,250 | 836,043 |
| All other grantees | 2,882,251 | 1,406,747 |

During 2008, our board of directors approved a stock option exchange program for certain share options that were granted during 2007 and 2008 until the date of the exchange program (the Options). Under the exchange program, we offered our employees the opportunity to exchange the Options for new options to be granted to them on the date of the exchange. These new options would have a new exercise price which would be equal to the closing price of our Ordinary shares on the NASDAQ Global Market on the date the new options were granted. As a result of the exchange, on November 6, 2008 391,000 options with an exercise price ranging between \$7 to 17 per share were cancelled and 391,000 options with an exercise price of \$5.65 per share were granted. According to the program, those new options will vest over a period of four years commencing on the date of the exchange.

Amendment

Subject to applicable law, our board of directors may amend the plan, provided that any action by our board of directors which will alter or impair the rights or obligations of an option holder requires the prior consent of that option holder.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**Major Shareholders**

The following table sets forth stock ownership information as of March 15, 2009 (unless otherwise noted below) with respect to each person who is known by us to be the beneficial owner of more than 5% of our outstanding ordinary shares, based on information provided to us

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by the holders or disclosed in public filings with the SEC.

Except where otherwise indicated, and except pursuant to community property laws, we believe, based on information furnished by such owners, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to such shares. The shareholders listed below do not have any different voting rights from any of our other shareholders. We know of no arrangements which would, at a subsequent date, result in a change of control of our company.

Total shares beneficially owned in the table below include shares that may be acquired upon the exercise of options that are exercisable within 60 days. The shares that may be issued under these options are treated as outstanding only for purposes of determining the percent owned by the person or group holding the options but not for the purpose of determining the percentage ownership of any other person or group. Each of our directors and officers who is also a director or officer of an entity listed in the table below disclaims ownership of our ordinary shares owned by such entity.

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| Name | Number of Ordinary Shares | Percentage of Outstanding Ordinary Shares ⁽¹⁾ |
|--|---------------------------|--|
| Zohar Zisapel ⁽²⁾⁽³⁾ | 4,441,559 | 12.8% |
| Yehuda Zisapel ⁽²⁾ | 2,238,000 | 6.6% |
| William Leland Edwards et al. ⁽⁴⁾ | 1,858,800 | 5.4% |

(1) Based on ordinary shares issued and outstanding as of March 15, 2009.

(2) Yehuda Zisapel and Zohar Zisapel are brothers. Each shareholder's address is 24 Raoul Wallenberg St., Tel Aviv 69719, Israel.

(3) During 2008, Zohar Zisapel increased his beneficial ownership of our ordinary shares by 1,011,872 shares, as reflected in a Statement on Schedule 13D filed with the SEC on November 24, 2008 by Mr. Zisapel.

(4) Based on information provided in a Statement on Schedule 13G filed with the SEC on February 17, 2009 by William Leland Edwards, Anthony Joonkyoo Yun, MD, Palo Alto Investors, Palo Alto Investors LLC (PAI). Palo Alto Investors is the manager of PAI. William Leland Edwards is the controlling shareholder of Palo Alto Investors and has sole voting and dispositive power over 28,200 of the ordinary shares, and shared voting and dispositive power over 1,830,600 of the ordinary shares. Anthony Joonkyoo Yun, MD, is the President of Palo Alto Investors and PAI. Dr. Yun, Palo Alto Investors and PAI have shared voting and dispositive power over 1,830,600 of the ordinary shares. The principal business office of the shareholder is 470 University Avenue, Palo Alto, California, 94301.

As of March 15, 2009, approximately 87% of our ordinary shares were held in the United States and there were 33 record holders with addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 94% of our outstanding ordinary shares as of said date).

Related Party Transactions

The RAD-BYNET Group of Companies

Yehuda Zisapel is a principal shareholder who, as of March 15, 2009, beneficially owns 6.6% of our ordinary shares. Zohar Zisapel, the Chairman of our board of directors and a principal shareholder of our company, beneficially owns 12.8% of our ordinary shares as of March 15, 2009. They are brothers who do not vote as a group and do not have a voting agreement. Individually or together, they are also founders, directors or principal shareholders of several other companies which, together with us and the other affiliates, are known as the RAD-BYNET group. These corporations include the following, as well as several other real estate, holding, biotech and pharmaceutical companies:

| | | |
|--------------------------------|---|----------------|
| AB-NET Communications Ltd. | Internet Binat Ltd. | RADLive Ltd. |
| BYNET Data Communications Ltd. | Packetlight Networks Ltd. | RADVision Ltd. |
| BYNET Electronics Ltd. | RAD-Bynet Properties and Services (1981) Ltd. | RADWARE Ltd. |

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| | | |
|---------------------------------|---|--------------|
| BYNET SEMECH (Outsourcing) Ltd. | | RADWIN Ltd. |
| BYNET Software Systems Ltd. | RADCOM Ltd. | SANRAD Inc. |
| BYNET Systems Applications Ltd. | RAD Data Communications Ltd. and its subsidiaries | SILICOM Ltd. |
| Chanellot Ltd. | | WISAIR Inc. |
| Commex Technologies Ltd. | | |

The above list does not constitute a complete list of the investments of Messrs. Yehuda and Zohar Zisapel.

Mr. Atsmon, one of our directors, also serves as a director of RADVision Ltd., another company in the RAD-BYNET group. Ms Langer, one of our directors, acts as general counsel for several companies in the RAD- BYNET group.

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In addition to engaging in other businesses, members of the RAD-BYNET group are actively engaged in designing, manufacturing, marketing and supporting data communications products, none of which currently compete with our products. Some of the products of members of the RAD-BYNET group are complementary to, and may be used in connection with, our products.

Members of the RAD-BYNET group provide us on an as-needed basis with management information systems, marketing, and administrative services, and we reimburse each company for its costs in providing these services. Members of the RAD-BYNET provide us and other RAD-BYNET companies with logistics services such as transportation and cafeteria facilities. We lease our offices from other members of the RAD-BYNET group. The aggregate amount of these expenses was approximately \$2.6 million in 2008.

We generally ascertain the market prices for goods and services that can be obtained at arms length from unaffiliated third parties before entering into any transaction with a member of the RAD-BYNET group for those goods and services. In addition, all of our transactions to date with members of the RAD-BYNET group were approved by our board of directors and audit committee. As a result, we believe that the terms of the transactions in which we have engaged and are currently engaged with other members of the RAD-BYNET group are beneficial to us and no less favorable to us than terms which might be available to us from unaffiliated third parties. Any future transaction and arrangement with entities, including other members of the RAD-BYNET group, in which our office holders have a personal interest will require approval by our audit committee, our board of directors and, if applicable, our shareholders.

Lease Arrangements

We lease most of our office space for our current headquarters and principal administrative, finance, marketing and sales operations from real estate holding companies controlled by Yehuda and Zohar Zisapel. The leased facility is approximately 51,100 square feet in size. The leases for the majority of this facility are valid until December 2010, with an option to renew for an additional two-year period. Additionally, we lease space for our U.S. headquarters from a real estate holding company controlled by Yehuda Zisapel and Zohar Zisapel. This facility is approximately 5,800 square feet in size. The lease for this facility is valid until July 2013. The aggregate amount of rent and maintenance expenses related to these properties was approximately \$1.4 million in 2008.

Supply Arrangement

We purchase components and products from RAD Data Communications Ltd., RADWIN Ltd. and other members of the RAD-BYNET group which we integrate into our products or product offerings. The aggregate purchase price of these components was approximately \$4.3 million for the year ended December 31, 2008.

Registration Rights

In connection with the private placement of preferred shares before our initial public offering in August 2000, several of our shareholders were granted registration rights with respect to ordinary shares which resulted following conversion of their preferred shares immediately prior to the completion of our initial public offering. The agreement grants registration rights to each of:

the majority of the holders of the ordinary shares resulting from the conversion of such preferred shares; and

Yehuda Zisapel and Zohar Zisapel.

Under the agreement, each of these shareholders has the right to have its ordinary shares included in certain of our registration statements.

ITEM 8: FINANCIAL INFORMATION

Consolidated Statements and Other Financial Information

The annual financial statements required by this item are found at the end of this Annual Report, beginning on Page F-1.

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Export Sales

In 2008, 99% of our sales were to customers located outside of Israel.

Legal Proceedings

We are not a party to any material legal proceedings, nor have there been any material legal proceedings in which any of our directors, members of senior management, or affiliates is either a party adverse to us or has a material interest adverse to us. There are no material legal or governmental proceedings which we know to be pending against us.

Dividends

We have never declared or paid any dividend on our ordinary shares and we do not anticipate paying any dividends on our ordinary shares in the future, except for the share dividend that was paid as a result of a 250-for-1 share recapitalization that took place immediately prior to our initial public offering. We currently intend to retain all future earnings to finance our operations and to expand our business.

No Significant Changes

No significant changes to Ceragon's financial condition have occurred since the date of the annual financial statements included herein.

ITEM 9: THE OFFER AND LISTING

Offer and Listing Details

Our ordinary shares have been listed on the Nasdaq Global Market, or Nasdaq, since August 4, 2000 and on the Tel Aviv Stock Exchange, or TASE, since September 12, 2004, both under the symbol CRNT.

The table below sets forth for the periods indicated the high and low market prices of our ordinary shares as reported on Nasdaq.

| | Ordinary Shares | |
|---------------|-----------------|---------|
| | High | Low |
| 2004 (Annual) | \$ 8.74 | \$ 3.70 |
| 2005 (Annual) | 6.77 | 3.40 |
| 2006 (Annual) | 5.74 | 3.87 |
| 2007 (Annual) | 21.89 | 5.11 |

| | <u>Ordinary Shares</u> | |
|--|------------------------|---------|
| 2008 (Annual) | 11.59 | 4.30 |
| 2007 | | |
| First Quarter | 6.33 | 5.11 |
| Second Quarter | 11.86 | 5.55 |
| Third Quarter | 19.22 | 11.53 |
| Fourth Quarter | 21.89 | 9.72 |
| 2008 | | |
| First Quarter | 11.59 | 6.07 |
| Second Quarter | 11.45 | 7.50 |
| Third Quarter | 9.51 | 6.30 |
| Fourth Quarter | 7.56 | 4.30 |
| 2009 | | |
| First Quarter (through March 13, 2009) | \$ 5.68 | \$ 4.17 |

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The table below sets forth the high and low market prices for our shares on Nasdaq during the most recent six-month period:

| | <u>High</u> | <u>Low</u> |
|-------------------------------------|-------------|------------|
| September 2008 | \$ 9.51 | \$ 7.05 |
| October 2008 | 7.56 | 4.30 |
| November 2008 | 6.14 | 4.42 |
| December 2008 | 5.65 | 4.62 |
| January 2009 | 5.83 | 4.76 |
| February 2009 | 5.68 | 4.46 |
| March 2009 (through March 13, 2009) | 4.78 | 4.17 |

The table below sets forth for the periods indicated the high and low market prices of our ordinary shares on the TASE. The translation from NIS into U.S. dollars for the following two tables is based on representative rates of exchange published by the Bank of Israel.

| | <u>High</u> | <u>Low</u> |
|----------------------|-------------|------------|
| 2005 (Annual) | \$ 6.67 | \$ 3.46 |
| 2006 (Annual) | 5.70 | 3.79 |
| 2007 (Annual) | 20.33 | 5.15 |
| 2008 (Annual) | 11.56 | 4.57 |
| 2007 | | |
| First Quarter | 6.40 | 5.15 |
| Second Quarter | 11.20 | 5.67 |
| Third Quarter | 18.68 | 11.28 |
| Fourth Quarter | 20.33 | 9.79 |
| 2008 | | |

2008

| | High | Low |
|--|-------|------|
| First Quarter | 11.56 | 6.15 |
| Second Quarter | 11.30 | 7.40 |
| Third Quarter | 9.49 | 6.37 |
| Fourth Quarter | 7.43 | 4.57 |
| 2009 | | |
| First Quarter (through March 13, 2009) | 5.59 | 4.20 |

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The table below sets forth the high and low market prices for our shares on the TASE during the most recent six-month period:

| | High | Low |
|-------------------------------------|---------|---------|
| September 2008 | \$ 9.49 | \$ 7.31 |
| October 2008 | 7.43 | 4.48 |
| November 2008 | 6.27 | 4.34 |
| December 2008 | 5.89 | 4.66 |
| January 2009 | 5.84 | 4.81 |
| February 2009 | 5.59 | 4.56 |
| March 2009 (through March 13, 2009) | 4.69 | 4.20 |

Markets

See Offer and Listing Details above.

ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

A description of our memorandum and articles of association was previously provided in our registration statement on Form F-1 (Registration Statement 333-12312) filed with the SEC on August 3, 2000, and is incorporated herein by reference. The memorandum of association and articles of association as amended in October 2007 were previously provided in our annual report on Form 20-F for the year 2007 and are incorporated herein by reference.

Material Contracts

None.

Exchange Controls

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

The ownership or voting of our ordinary shares by non-residents of Israel, except with respect to citizens of countries which are in a state of war with Israel, is not restricted in any way by our memorandum of association or articles of association or by the laws of the State of Israel.

Taxation

The following is a short summary of the tax environment to which shareholders may be subject. The following is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. Each individual should consult his or her own tax or legal advisor.

This summary is based on the current provisions of tax law and, except for the foregoing, does not anticipate any possible changes in law, whether by legislative, regulatory, administrative or judicial action. Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares.

General Corporate Tax Structure in Israel

Israeli companies are generally subject to corporate tax on their taxable income at the rate of 27% for the 2008 tax year. Following an amendment to the Israeli Income Tax Ordinance [New Version], 1961 (the Israeli Tax Ordinance), which came into effect on January 1, 2006, the corporate tax rate is scheduled to decrease to 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter. Israeli companies are generally subject to capital gains tax at a rate of 25% for capital gains (other than gains deriving from the sale of listed securities) derived after January 1, 2003.

However, the effective tax rate payable by a company that derives income from an approved enterprise, discussed further below, may be considerably lower. See *The Law for the Encouragement of Capital Investments, 1959* below.

The Law for the Encouragement of Capital Investments, 1959

Tax Benefits before the 2005 amendment

The Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investments Law, provides that a proposed capital investment in eligible facilities may be designated as an approved enterprise. See *Tax Benefits under the 2005 Amendment* below regarding an amendment to the Investments Law that came into effect in 2005.

Each certificate of approval for an approved enterprise, received upon application to the Investment Center of the Ministry of Industry, Trade and Labor of the State of Israel, or the Investment Center, relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, for example, the equipment to be purchased and utilized under the program. The tax benefits derived from any certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments is approved, its effective tax rate is the result of a weighted average of the applicable rates.

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 rates, for the benefit period. This period is ordinarily seven or ten years depending upon the geographic location of the approved enterprise within Israel, and whether the company qualifies as a foreign investors' company as described below, commencing with the year in which the approved enterprise first generates taxable income after the commencement of production. Tax benefits under the Investments Law may 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.

A company owning an approved enterprise may elect to forego certain government grants extended to an approved enterprise in return for an alternative package of benefits. Under the alternative package of benefits, a company's undistributed income derived from an approved enterprise will be exempt from company tax for a period of between two and ten years from the first year of taxable income after the commencement of production, depending on the geographic location of the approved enterprise within Israel, and the company will be eligible for a reduced tax rate for the remainder of the benefits period. However, this period is limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier. This limitation does not apply to the exemption period.

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 in which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period (instead of seven). Depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two and ten years

and will be subject to a reduced tax rate for rest of the benefits period (up to eight years). The tax rate for the additional benefits period is 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate is 20% if the foreign investment is 49% or more and less than 74%; 15% if 74% or more and less than 90%; and 10% if 90% or more. A company that has elected the alternative package of benefits and that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to tax on the gross amount distributed. The tax rate will be the rate which would have been applicable had the company not elected the alternative package of benefits. This rate is generally 10%-25%, depending on the percentage of the company's shares held by foreign shareholders. The dividend recipient is subject to withholdings of tax at the source by the company at the reduced rate applicable to dividends from approved enterprises, which is 15% if the dividend is distributed during the tax exemption period or within 12 years after the period. This limitation does not apply to a foreign investors' company.

The benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investments Law and its regulations and the criteria in the specific certificate of approval, as described above. If a company does not meet these conditions, in whole or in part, it would be required to refund the amount of tax benefits, with the addition of the consumer price index linkage adjustment and interest.

The Investment Center has granted approved enterprise status to three investment programs at our former facility in Tel Aviv and we have derived and expect to continue to derive a substantial portion of our income from these programs. We have elected the alternative package of benefits under these approved enterprise programs. The portion of our income derived from these approved enterprise programs will be exempt from tax for a period of two years commencing in the first year in which there is taxable income after the commencement of production and will be subject to a reduced company tax of up to 25% for the subsequent period of five years, or up to eight years if the percentage of non-Israeli investors who hold our ordinary shares exceeds 25%. The period of tax benefits for our approved enterprise programs has not yet commenced, because we have yet to realize taxable income.

Tax Benefits under the 2005 Amendment

On April 1, 2005, an amendment to the Investments Law (the Amendment) came into force. The Amendment includes revisions to the criteria for investments qualified to receive tax benefits as an approved enterprise. The 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, whose benefits will remain 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 to the amendment) would not be allowed to choose a new tax year as a year of election (as described below) under the new amendment for a period of 3 years from the company's previous year of commencement under the old Investment Law.

The Company will continue to enjoy its current tax benefits in accordance with the provisions of the Investment Law prior to its revision. However, if the Company is granted any new benefits in the future, they will be subject to the provisions of the amended Investment Law. Therefore, the above discussion is a summary of the Investment Law prior to its amendment and the following is a discussion of the relevant changes contained in the new legislation.

The Amendment simplifies the approval process: according to the Amendment, only approved enterprises receiving cash grants require the approval of the Investment Center. The Investment Center was entitled to approve such programs only until December 31, 2007.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (referred to as a Benefited Enterprise). In order to receive the tax benefits, the Amendment states that the 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 (the Year of Election). A company wishing to receive the tax benefits afforded to a Benefited Enterprise is required to select the tax year from which the period of benefits under the Investments Law are to commence by notifying the Israeli Tax Authority within 12 months of the end of that year. Companies are also granted the right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment. 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 combination 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 before the expansion.

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The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the Commencement Year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to 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 distribute. 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) 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 Amendment changes the definition of *foreign investment* in the Investments Law so that the definition now requires a minimal investment of NIS 5 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 NIS 5 million. Such changes to the definition of *foreign investment* took effect retroactively from 2003.

Among the results of the Amendment are that (a) tax-exempt income generated under the provisions of the new law will subject us to taxes upon distribution or liquidation and (b) we may be required to record a deferred tax liability with respect to such tax-exempt income. As of December 31, 2008, we did not generate income under the provisions of the new law.

Tax Benefits and Grants for Research and Development

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

the expenditures are approved by the relevant Israeli government ministry, determined by the field of research;

the research and development is for the promotion or development of the company; and

the research and development is carried out by or on behalf of the company seeking the deduction.

However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period if the R&D is for the promotion or development of the company.

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

According to the Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, an industrial company is a company resident in Israel, at least 90% of the income of which, in a given tax year, determined in Israeli currency exclusive of income from 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 the Industry Encouragement Law, industrial companies are entitled to the following preferred corporate tax benefits, among others:

deduction of purchases of know-how, patents and the right to use a patent over an eight-year period for tax purposes;

deduction over a three-year period of specified expenses incurred with the issuance and listing of shares on the Tel Aviv Stock Exchange or on a recognized stock exchange outside of Israel (including Nasdaq);

the right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies; and

accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that we currently qualify as an industrial company within the definition of the Industry Encouragement Law. We cannot assure you that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

Special Provisions Relating to Taxation under Inflationary Conditions

Under the Income Tax (Inflationary Adjustments) Law, 1985, results for tax purposes were measured in real terms in accordance with the changes in the Israeli Consumer Price Index (Israeli CPI). Accordingly, until 2002, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. Commencing in fiscal year 2003, we have elected to measure our taxable income and file our tax return under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Such an election obligated us for three years. Accordingly, commencing with fiscal year 2003, results for tax purposes are measured in terms of earnings in dollars. We filed for one-year extensions in 2006 and 2007. Beginning January 1, 2008, the Inflationary Adjustments Law was repealed.

Israeli Capital Gains Tax on Sales of Shares

Israeli law imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain that 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, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, retroactive from January 1, 2003, 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 significant shareholder at any time during the 12-month period preceding such sale (i.e. such shareholder holds directly or indirectly, including jointly with others, at least 10% of any means of control in the company) the tax rate will be 25%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of publicly-traded shares, unless such companies were not subject to the Inflationary Adjustments Law (or certain regulations) as of August 10, 2005, in which case the applicable tax rate is 25%. However, the foregoing tax rates would not apply to dealers in securities and shareholders who acquired their shares prior to an initial public offering.

The tax basis of publicly-traded 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 publicly traded on the TASE, provided such gains did not derive from a permanent establishment of such shareholders in Israel, and 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 market outside of Israel (including Nasdaq), provided however that such capital gains are not derived from a permanent establishment in Israel, that such shareholders are not subject to the Inflationary Adjustments Law and that 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 of 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.

Under the convention between the United States and Israel concerning taxes on income, as amended (the U.S.-Israel Tax Treaty), generally, Israeli capital gains tax will not apply to the sale, exchange or disposition of ordinary shares by a person who:

holds the ordinary shares as a capital asset; and

qualifies as a resident of the United States within the meaning of the U.S.-Israel tax treaty; and

is entitled to claim the benefits available to the person by the U.S.-Israel tax treaty.

However, this exemption will not apply if (i) the treaty U.S. resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding the sale, exchange or disposition, subject to specified conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In this case, the sale, exchange or disposition would be subject to Israeli tax, to the extent applicable. However, under the U.S.-Israel tax treaty, the treaty U.S. resident would be permitted to claim a credit for the taxes against the U.S. federal income tax imposed on the 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.

Israeli Taxation of Dividends Distributed to Non-Resident Holders of Our Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. These sources of income include passive income, including dividends, royalties and interest, as well as non-passive income from services provided in Israel. On distributions of dividends other than bonus shares or stock dividends, income tax is withheld at source at the following rates: (i) for dividends distributed prior to January 1, 2006 25%; (ii) for dividends distributed on or after January 1, 2006 20%, or 25% for a shareholder that is considered a significant shareholder at any time during the 12-month period preceding such distribution; unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. As stated earlier, dividends of income generated by an approved enterprise are subject to withholding tax at a rate of 15%.

| Dividends not generated by an approved enterprise (or Benefited Enterprise) | | |
|--|--|---------------------------|
| Dividends generated by an approved enterprise (or Benefited Enterprise) | U.S. company holding 10% or more 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 | Other non-resident |
| 15% | 12.5% | 20%-25% |

Israeli Transfer Pricing Regulations

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Tax Ordinance, came into effect (the TP Regs). Section 85A of the Tax Ordinance and the TP Regs generally requires that all cross-border transactions carried out between related parties be conducted on an arm's length principle basis and will be taxed accordingly. The TP Regs have not had a material effect on the Company.

U.S. Federal Income Tax Considerations

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Subject to the limitations described below, the following discussion summarizes certain U.S. federal income tax consequences of the purchase, ownership and disposition of our ordinary shares to a U.S. holder that owns our ordinary shares as a capital asset (generally, for investment). A U.S. holder is a holder of our ordinary shares that is for U.S. federal income tax purposes:

an individual citizen or resident of the United States;

a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States, any political subdivision thereof or the District of Columbia;

an estate, the income of which is subject to U.S. federal income tax regardless of its source; or

a trust if (i) a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

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

Certain aspects of U.S. federal income taxes relevant to a holder of our ordinary shares (other than a partnership) that is not a U.S. holder (a Non-U.S. holder) are also discussed below.

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

are broker-dealers or insurance companies;

have elected mark-to-market accounting;

are tax-exempt organizations or retirement plans;

are grantor trusts;

are certain former citizens or long-term residents of the United States;

are financial institutions or financial services entities;

hold ordinary shares as part of a straddle, hedge or conversion transaction with other investments;

acquired their ordinary shares upon the exercise of employee stock options or otherwise as compensation;

are real estate investment trusts or regulated investment companies;

own directly, indirectly or by attribution at least 10% of our voting power; or

have a functional currency that is not the U.S. dollar.

This discussion is not a comprehensive description of all of the tax considerations that may be relevant to each person's decision to purchase our ordinary shares. For example, this discussion does not address any aspect of state, local or non-U.S. tax laws or the possible application of

United States federal gift or estate taxes.

Each holder of our ordinary shares is advised to consult his or her own tax advisor with respect to the specific tax consequences to him or her of purchasing, owning or disposing of our ordinary shares, including the applicability and effect of federal, state, local and foreign income and other tax laws to his or her particular circumstances.

Taxation of Distributions Paid on Ordinary Shares

Subject to the discussion below under Tax Consequences if We Are a Passive Foreign Investment Company, a U.S. holder will be required to include in gross income as dividend income the amount of any distribution paid on our ordinary shares, including any non-U.S. taxes withheld from the amount paid, on the date the distribution is received to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Distributions in excess of earnings and profits will be applied against and will reduce the U.S. holder's tax basis in its ordinary shares and, to the extent in excess of that basis, will be treated as gain from the sale or exchange of ordinary shares. The dividend portion of such distribution generally will not qualify for the dividends received deduction otherwise available to corporations.

Dividends that are received by U.S. holders that are individuals, estates or trusts will be taxed at the rate applicable to long-term capital gains (currently a maximum rate of 15% for taxable years beginning on or before December 31, 2010), provided that such dividends meet the requirements of qualified dividend income. Subject to the holding period and risk-of-loss requirements discussed below, dividends paid by a foreign corporation that is not a passive foreign investment company (as discussed below) will be qualified dividend income if the stock with respect to which the dividend is paid is readily tradable on an established securities market in the United States such as the Nasdaq Global Market. Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders, are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend if (1) the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code Section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities) or (2) the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a passive foreign investment company (as such term is defined in the Code) for any year, dividends paid on our ordinary shares in such year or in the following year would not be qualified dividends. In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

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

U.S. holders will have the option of claiming the amount of any non-U.S. income taxes withheld at source either as a deduction from gross income or as a dollar-for-dollar credit against their U.S. federal income tax liability. Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the non-U.S. income taxes withheld, but the amount may be claimed as a credit against the individual's U.S. federal income tax liability. The amount of non-U.S. income taxes that may be claimed as a credit in any year is subject to complex limitations and restrictions, which must be determined on an individual basis by each shareholder. These limitations include rules which limit foreign tax credits allowable for specific classes of income to the U.S. federal income taxes otherwise payable on each such class of income.

The total amount of allowable foreign tax credits in any year cannot exceed the pre-credit U.S. tax liability for the year attributable to non-U.S. source taxable income. Distributions of current or accumulated earnings and profits will generally be non-U.S. source passive income for U.S. foreign tax credit purposes;

A U.S. holder will be denied a foreign tax credit for non-U.S. income taxes withheld from a dividend received on the ordinary shares if (1) the U.S. holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (2) to the extent the U.S. holder is under an obligation to make related payments with respect to positions in substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16-day holding period.

Taxation of the Disposition of Ordinary Shares

Subject to the discussion below under *Tax Consequences if We Are a Passive Foreign Investment Company*, upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the U.S. holder's basis in the ordinary shares, which is usually the cost to the U.S. holder of the ordinary shares, and the amount realized on the disposition. Capital gain from the sale, exchange or other disposition of ordinary shares held more than one year will be long-term capital gain and may, in the case of non-corporate U.S. holders, be subject to a reduced rate of taxation (long-term capital gains are currently taxable at a maximum rate of 15% for taxable years beginning on or before December 31, 2010). Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares will generally be treated as U.S. source income for U.S. foreign tax credit purposes. The deductibility of a capital loss recognized on the sale, exchange or other disposition of ordinary shares is subject to limitations.

A U.S. holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder may avoid realizing foreign currency gain or loss if he or she has elected to use the settlement date to determine its proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a U.S. holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be U.S. source ordinary income or loss.

Tax Consequences if We Are a Passive Foreign Investment Company

For U.S. federal income tax purposes, we will be classified as a passive foreign investment company, or PFIC, for any taxable year in which either, after applying certain look-through rules, (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average value of our total assets (determined on a quarterly basis) for the taxable year produce or are held for the production of passive income (the *Asset Test*). For this purpose, cash is considered to be an asset which produces passive income. Passive income includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of certain assets which produce passive income.

Based on our income, assets, activities and market capitalization, we do not believe that we were a PFIC for the taxable year ended December 31, 2008. However, there can be no assurances that the United States Internal Revenue Service (*IRS*) will not challenge this conclusion. If we were not a PFIC for 2008, U.S. holders who acquired our ordinary shares in 2008 will not be subject to the PFIC rules described below (regardless as to whether we were a PFIC in any prior years) unless we are classified as a PFIC in future years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of our future income, assets, activities and market capitalization, including fluctuations in the price of our ordinary shares, which are relevant to this determination.

If we are a PFIC, a U.S. holder of our ordinary shares could be subject to increased tax liability upon the sale or other disposition (including gain deemed recognized if the ordinary shares are used as security for a loan) of its ordinary shares or upon the receipt of amounts treated as excess distributions, which could result in a reduction in the after-tax return to such U.S. holder. In general, a excess distribution is the amount of distributions received during a taxable year that exceed 125% of the average amount of distributions received by a U.S. holder in respect of the ordinary shares during the preceding three taxable years, or if shorter, during the U.S. holder's holding period prior to the taxable year of the distribution. Under these rules, the excess distribution and any gain on the disposition of ordinary shares would be allocated ratably over the U.S. holder's holding period for the ordinary shares. The amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a PFIC would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that taxable year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. The tax liability with respect to the amount allocated to taxable years prior to the year of the disposition or distribution cannot be offset by net operating losses. In addition, holders of stock in a PFIC may not receive a *step-up* in basis on shares acquired for a decedent.

As an alternative to the tax treatment described above, a U.S. holder could elect to treat us as a *qualified electing fund* (*QEF*), in which case the U.S. holder would be required to include in income, for each taxable year that we are a PFIC, its pro rata share of our ordinary earnings as ordinary income and its pro rata share of our net capital gains as capital gain, subject to a separate election to defer payment of taxes which deferral is subject to an interest charge. We will supply U.S. holders that make a request in writing with the information needed to report income and gain under a QEF election if we are a PFIC. Any income inclusion will be required whether or not such U.S. holder owns our ordinary shares for an entire taxable year or at the end of our taxable year. The amount so includible will be determined without regard to our prior year losses or the amount of cash distributions, if any, received from us. Special rules apply if a U.S. holder makes a QEF election after the first year in its holding period in which we are a PFIC. A U.S. holder's basis in its ordinary shares will increase by any amount included in income and decrease by any amounts not included in income when distributed because such amounts were previously taxed under the QEF rules. So long as

a U.S. holder's QEF election is in effect with respect to the entire holding period for its ordinary shares, any gain or loss realized by such holder on the disposition of its ordinary shares held as a capital asset ordinarily would be capital gain or loss. Such capital gain or loss ordinarily would be long-term if such U.S. holder had held such ordinary shares for more than one year at the time of the disposition. For non-corporate U.S. holders, long-term capital gain is generally subject to a maximum federal income tax rate of 15% for taxable years beginning on or before December 31, 2010. The QEF election is made on a shareholder-by-shareholder basis, applies to all ordinary shares held or subsequently acquired by an electing U.S. holder and can be revoked only with the consent of the IRS.

Although a U.S. holder normally is not permitted to make a retroactive QEF election, a retroactive election may be made for a taxable year of the U.S. holder (the retroactive election year) if the U.S. holder (i) reasonably believed that, as of the date the QEF election was due, the foreign corporation was not a PFIC for its taxable year that ended during the retroactive election year and (ii) filed a protective statement with respect to the foreign corporation, applicable to the retroactive election year, in which the U.S. holder described the basis for its reasonable belief and extended the period of limitation on the assessment of taxes determined under Sections 1291 through 1298 of the Code with respect to the foreign corporation (PFIC related taxes) for all taxable years of the shareholder to which the protective statement applies. We will supply U.S. holders that make a request in writing with the information needed to report income and gain under a QEF election if we are a PFIC.

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

The U.S. federal income tax consequences to a U.S. holder if we were to be classified as a PFIC in 2008 or any previous taxable year are complex. A U.S. holder should consult with his or her own advisor with regard to those consequences, as well as with regard to whether he or she should make either of the elections described above.

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

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

the item is effectively connected with the conduct by the Non-U.S. holder of a trade or business in the United States and in the case of a resident of a country which has a treaty with the United States, the item is attributable to a permanent establishment, or in the case of an individual, the item is attributable to a fixed place of business in the United States; or

the Non-U.S. holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met.

Information Reporting and Back-up Withholding

U.S. holders generally are subject to information reporting requirements with respect to dividends paid in the United States on, or proceeds from the disposition of, our ordinary shares. In addition, a U.S. holder may be subject, under certain circumstances, to backup withholding at a rate of up to 28% with respect to dividends paid on, or proceeds from the disposition of, our ordinary shares unless the U.S. holder provides proof of an applicable exemption or correct taxpayer identification number and otherwise complies with the applicable requirements of the backup withholding rules. A U.S. holder of our ordinary shares who provides an incorrect taxpayer identification number may be subject to

penalties imposed by the IRS. Amounts withheld under the backup withholding rules are not an additional tax and may be refunded or credited against the U.S. holder's federal income tax liability, provided the required information is furnished to the IRS.

Non-U.S. holders generally are not subject to information reporting or back-up withholding with respect to dividends paid in the United States on, or proceeds from the disposition of, our ordinary shares, provided that the Non-U.S. holder provides a taxpayer identification number, certifies to its foreign status, or establishes another exemption to the information reporting or back-up withholding requirements.

Documents on Display

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, applicable to foreign private issuers and fulfill the obligations with respect to such requirements by filing reports with the SEC. These reports include certain financial and statistical information about us, and may be accompanied by exhibits. You may read and copy any document we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms.

The SEC maintains an Internet website at <http://www.sec.gov> that contains reports, proxy statements, information statements and other material that are filed through the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system.

You may also visit us on the World Wide Web at www.ceragon.com. However, information contained on our website does not constitute a part of this Annual Report.

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ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not use derivative financial instruments for trading purposes. Accordingly, we have concluded that there is no material market risk exposure of the type contemplated by Item 11, and that no quantitative tabular disclosures are required. We are exposed to certain other types of market risks, as described below.

We are exposed to financial market risk associated with changes in foreign currency exchange rates. A majority of our revenue is generated, and a substantial portion of our expenses is incurred, in dollars. A portion of our expenses, however, is denominated mainly in NIS. Since our financial results are reported in dollars, fluctuations in the rates of exchange between the dollar and non-dollar currencies may have an effect on our results of operations. In order to reduce such effect, we hedge a portion of certain cash flow transactions denominated in non-dollar currencies as well as a portion of certain monetary items in the balance sheet, such as trade receivables and trade payables, denominated in non-dollar currencies. The following sensitivity analysis assumes an instantaneous 10% change in foreign currency exchange rates from year-end levels, with all other variables held constant. At December 31, 2008, a 10% strengthening of the U.S. dollar versus other currencies would have resulted in an increase of approximately \$900 thousand in our net assets position, while a 10% weakening of the dollar versus all other currencies would have resulted in a decrease of approximately \$900 thousand.

The counter-parties to our hedging transactions are major financial institutions with high credit ratings. As of December 31, 2008, we had forward contracts to sell up to \$22.6 million for a total amount of approximately NIS 86.6 million (that would mature on or before December 31, 2009), and forward contracts to sell up to 3.0 million for a total of approximately \$4.2 million (that would mature on March 31, 2009). During the year ended December 31, 2008 we recognized a profit of \$1.4 million as a result of derivative instruments.

We invest in investment grade U.S. corporate and government bonds and dollar deposits with banks. Since these investments typically carry fixed interest rates and since our policy and practice is to hold these investments to maturity, financial income over the holding period is not sensitive to changes in interest rates.

We do not invest in interest rate derivative financial instruments.

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 PROCEEDS.

Amendment to Articles

In October, 2007, our shareholders approved an amendment to our Memorandum of Association and Articles of Association to reflect an increase in the registered share capital of the Company from NIS 400,000 divided into 40 million shares to NIS 600,000 divided into 60 million shares of a nominal value of One Agora (NIS 0.01) each.

This amendment was described in Item A of our Notice and Proxy Statement for the Annual General Meeting of our shareholders held on October 25, 2007, included in our report on Form 6-K, furnished to the SEC on September 24, 2007, which is incorporated herein by reference. The text of the amendments to our Memorandum and Articles of Association as amended in October 2007 are incorporated herein by reference.

Use of Proceeds

As of December 31, 2008, approximately 70% of the net offering proceeds remaining from our initial public offering and from our follow-on offering was invested in short-term investments. The 30% balance of the net offering proceeds was invested in long-term investments. During fiscal year 2008, we used the proceeds for capital expenditures, repurchase of the Company's shares and general corporate purposes.

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ITEM 15. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

The Company performed an evaluation of the effectiveness of its disclosure controls and procedures that are designed to ensure that the material financial and non-financial information required to be disclosed to the SEC is recorded, processed, summarized and reported timely. Based on the Company's evaluation, the Company's management, including the CEO and CFO, has concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report are effective. Notwithstanding the foregoing, there can be no assurance that the Company's disclosure controls and procedures will detect or uncover all failures of persons within Ceragon to disclose material information otherwise required to be set forth in the Company's reports.

(b) Management's Report on Internal Control Over Financial Reporting

The Company performed an evaluation of the effectiveness of its internal control over financial reporting that is designed by, or under the supervision of, the Company's principal executive and principal financial officers, and effected by the Company's board of directors, management and other personnel, 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 and includes those policies and procedures that:

(i) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) 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

(iii) 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.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2008 based on the framework for Internal Control-Integrated Framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on the Company's evaluation, our management, including the CEO and CFO, has concluded that the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report are effective. Notwithstanding the foregoing, there can be no assurance that the Company's internal control over financial reporting will detect or uncover all failures of persons within Ceragon to comply with these procedures.

(c) Attestation Report of Independent Registered Public Accounting Firm

Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global, our independent registered public accounting firm, has issued an attestation report on the effectiveness of our internal control over financial reporting, appearing under Item 18. Financial Statements on page F-3, and such report is incorporated herein by reference.

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(d) Changes in Internal Controls Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the year ended December 31, 2008 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 Company's board of directors has determined that Mr. Joseph Atsmon is the audit committee financial expert. Mr. Atsmon is one of our independent directors for the purposes of the Nasdaq Rules.

ITEM 16B. CODE OF ETHICS

In November 2003, the Company's board of directors adopted a Code of Ethics that applies to the chief executive officer, chief financial officer and controller. In October 2008, we amended our Code of Ethics in order to update it and expand its applicability to additional senior officers. A copy of the Company's Code of Ethics may be obtained, without charge, upon a written request addressed to the Company's investor relations department, 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel (Telephone no. +972-3-645-5733) (e-mail: ir@ceragon.com).

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Fees Paid to Independent Registered Public Accounting Firm

The following table sets forth, for each of the years indicated, the fees billed by our independent registered public accounting firm and the percentage of each of the fees out of the total amount billed by the auditors.

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| Services Rendered | Year Ended December 31, | | | |
|-------------------|-------------------------|-------------|------------|-------------|
| | 2007 | | 2008 | |
| | Fees | Percentages | Fees | Percentages |
| Audit (1) | \$ 260,000 | 85 | \$ 240,000 | 89 |
| Audit-related(2) | 10,000 | 3 | - | - |
| Tax (3) | 38,000 | 12 | 30,000 | 11 |
| Total | \$ 308,000 | 100 | \$ 270,000 | 100 |

- (1) Audit fees consist of services that would normally be provided in connection with statutory and regulatory filings or engagements, including services that generally only the independent accountant can reasonably provide. These fees include fees for the audit of internal control over financial reporting and the work related to our follow-on equity offering that occurred in 2007.
- (2) Audit-related fees relate to assurance and associated services that traditionally are performed by the independent registered public accounting firm, including: accounting consultation and consultation concerning financial accounting and reporting standards.
- (3) Tax fees relate to tax compliance, planning and advice.

Policies and Procedures

Our Audit Committee has adopted a policy and procedures for approval of audit and non-audit services rendered by our independent auditors, Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global. The policy requires the Audit Committee's approval of the scope of the engagement of our independent auditor. The policy prohibits retention of the independent auditors to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act of 2002 or the rules of the SEC, and also considers whether proposed services are compatible with the independence of the public auditors.

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

None.

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

The chart below provides information on our purchases of our ordinary shares during the year ended December 31, 2008:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Programs (1) |
|--------------------------------------|----------------------------------|------------------------------|--|---|
| January 1 through January 31, 2008 | 0 | N/A | 0 | N/A |
| February 1 through February 29, 2008 | 0 | N/A | 0 | N/A |
| March 1 through March 31, 2008 | 0 | N/A | 0 | N/A |

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Programs (1) |
|--|---|------------------------------------|--|--|
| April 1 through April 30, 2008 | 0 | N/A | 0 | N/A |
| May 1 through May 31, 2008 | 0 | N/A | 0 | N/A |
| June 1 through June 30, 2008 | 0 | N/A | 0 | N/A |
| July 1 through July 31, 2008 | 0 | N/A | 0 | N/A |
| August 1 through August 31, 2008 | 0 | N/A | 0 | N/A |
| September 1 through September 30, 2008 | 0 | N/A | 0 | N/A |
| October 1 through October 31, 2008 | 0 | N/A | 0 | N/A |
| November 1 through November 30, 2008 | 812,792 | \$5.35 | 812,792 | \$15,655,236 |
| December 1 through December 31, 2008 | 687,011 | \$5.15 | 1,499,803 | \$12,115,026 |

- (1) On October 27, 2008, our board of directors authorized a share repurchase program under which the total amount to be paid for the repurchase of shares would not exceed \$20 million. The timing and the amounts purchased will be at the Company's discretion, and the purchases may occur in the open market or in negotiated or block transactions, all subject to regulatory requirements. As of December 31, 2008, we had purchased 1,499,803 shares at a weighted average price per share of approximately \$5.28 per share.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

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ITEM 16G. CORPORATE GOVERNANCE

The Nasdaq Rules provide that foreign private issuers may follow home country practice in lieu of the certain qualitative listing requirements subject to certain exceptions and except to the extent that such exemptions would be contrary to U.S. federal securities laws, so long as the foreign issuer discloses that it does not follow such listing requirement and describes the home country practice followed in its reports filed with the SEC. The practices we follow in lieu of Nasdaq Rules are described below:

The Nasdaq Rules require shareholder approval of stock option plans available to officers, directors or employees. We have decided to follow home country practice in lieu of obtaining shareholder approval for our share option plans. We seek shareholder approval for the adoption or amendment of share option plans only as required by our share option plans and Articles of Association and under Israeli law. Subject to exceptions permitted under the Companies Law, we are required to seek shareholder approval of any grants of share options to directors and controlling shareholders or plans that require shareholder approval for other reasons.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

The Consolidated Financial Statements and related notes thereto required by this item are contained on pages F-1 through F-34 hereof.

| Index to Consolidated Financial Statements | PAGE |
|--|------------|
| Reports of Independent Registered Public Accounting Firm | F-2 - F-3 |
| Consolidated Balance Sheets at December 31, 2008 and 2007 | F-4 - F-5 |
| Consolidated Statements of Operations for the Years Ended December 31, 2008, 2007 and 2006 | F-6 |
| Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2008, 2007 and 2006 | F-7 |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006 | F-8 |
| Notes to Consolidated Financial Statements | F-9 - F-34 |

ITEM 19. EXHIBITS

- 1.1 Memorandum of Association, as amended October 25, 2007 (English translation)*
- 1.2 Articles of Association, as amended October 25, 2007 *
- 4.1 Tenancy Agreement, dated as of February 22, 2000, by and among the Company, Zisapel Properties Ltd. and Klil & Michael Properties Ltd. (English translation)**
- 8.1 List of Subsidiaries
- 10.1 Consent of Independent Registered Public Accounting Firm
- 12.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 12.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 13.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Previously filed as exhibits 1.1 and 1.2 to the Company's Annual Report on Form 20-F for the year 2007 and incorporated herein by reference.

** Previously filed as exhibit 10.3 in connection with the Company's Registration Statement on Form F-1 (Registration Statement 333-12312) on August 3, 2000 and incorporated herein by reference.

SIGNATURE

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

CERAGON NETWORKS LTD.

By: /s/ Ira Palti

Ira Palti
President and Chief Executive Officer

SIGNATURE

Date: April 1, 2009

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS**AS OF DECEMBER 31, 2008****IN U.S. DOLLARS****INDEX**

| | <u>Page</u> |
|---|-------------------|
| <u>Report of Independent Registered Public Accounting Firm</u> | F-2 - F-3 |
| <u>Consolidated Balance Sheets</u> | F-4 - F-5 |
| <u>Consolidated Statements of Operations</u> | F-6 |
| <u>Statements of Changes in Shareholders' Equity</u> | F-7 |
| <u>Consolidated Statements of Cash Flows</u> | F-8 |
| <u>Notes to Consolidated Financial Statements</u> | F-9 - F-34 |

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**To the Shareholders and Board of Directors of****Ceragon Networks Ltd.**

We have audited the accompanying consolidated balance sheets of Ceragon Networks Ltd. (the Company) and subsidiaries as of December 31, 2007 and 2008, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries at December 31, 2007 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 1, 2009 expressed an unqualified

opinion thereon.

Tel-Aviv, Israel
April 1, 2009

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

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL
CONTROL OVER FINANCIAL REPORTING**

**To the Shareholders and Board of Directors of
Ceragon Networks Ltd.**

We have audited Ceragon Networks Ltd. (the Company) internal control over financial reporting as of December 31, 2008, 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 included in the accompanying management's report on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained in all material respects, effective internal control over financial reporting as of December 31, 2008, 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 subsidiaries as of December 31, 2007 and 2008, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008 and our report dated April 1, 2009 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
April 1, 2009

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

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CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | Note | December 31, | |
|---|------|-------------------|-------------------|
| | | 2007 | 2008 |
| ASSETS | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | | \$ 58,650 | \$ 28,224 |
| Short-term bank deposits | | 25,997 | 35,044 |
| Short-term marketable securities | 3 | 6,399 | 2,187 |
| Trade receivables (net of allowance for doubtful accounts of \$ 1,279 and \$ 2,517 at December 31, 2007 and 2008, respectively) | | 40,533 | 70,811 |
| Other accounts receivable and prepaid expenses | 4 | 10,888 | 11,508 |
| Deferred tax asset | | - | 4,082 |
| Inventories | 5 | 36,763 | 40,113 |
| | | <u>179,230</u> | <u>191,969</u> |
| <u>Total</u> current assets | | | |
| LONG-TERM ASSETS: | | | |
| Long-term bank deposits | | 12,030 | 8,204 |
| Long-term marketable securities | 3 | 18,665 | 24,102 |
| Severance pay fund | | 3,268 | 4,065 |
| Long term deferred tax asset | | - | 8,007 |
| | | <u>33,963</u> | <u>44,378</u> |
| <u>Total</u> long-term assets | | | |
| PROPERTY AND EQUIPMENT, NET | 6 | 4,447 | 8,891 |
| | | <u>\$ 217,640</u> | <u>\$ 245,238</u> |
| <u>Total</u> assets | | | |

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

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CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

December 31,

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| | | December 31, | |
|---|------|-------------------|-------------------|
| | Note | 2007 | 2008 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Trade payables | | \$ 26,341 | \$ 41,748 |
| Deferred revenues | | 6,702 | 5,886 |
| Other accounts payable and accrued expenses | 7 | 13,767 | 8,041 |
| | | <u>46,810</u> | <u>55,675</u> |
| Total current liabilities | | <u>46,810</u> | <u>55,675</u> |
| LONG TERM LIABILITIES: | | | |
| Accrued severance pay | | 5,286 | 6,647 |
| Other payables | 8a | 4,650 | - |
| | | <u>9,936</u> | <u>6,647</u> |
| Total long-term liabilities | | <u>9,936</u> | <u>6,647</u> |
| COMMITMENTS AND CONTINGENT LIABILITIES | | | |
| | 8 | | |
| SHAREHOLDERS' EQUITY: | | | |
| | 9 | | |
| Share capital - | | | |
| Ordinary shares of NIS 0.01 par value - | | | |
| Authorized: 60,000,000 shares at December 31, 2007 and 2008; | | | |
| Issued: 36,918,196 and 37,086,504 shares at December 31, 2007 | | | |
| and 2008, respectively; Outstanding: 36,918,196 and 35,586,701 | | | |
| and shares at December 31, 2007 and 2008, respectively. | | | |
| | | 91 | 91 |
| Additional paid-in capital | | 281,086 | 285,141 |
| Treasury shares at cost - 1,499,803 ordinary shares as of December 31, 2008 | | - | (7,923) |
| Accumulated other comprehensive income, net of taxes | | 280 | 193 |
| Accumulated deficit | | (120,563) | (94,586) |
| | | <u>160,894</u> | <u>182,916</u> |
| Total shareholders' equity | | <u>160,894</u> | <u>182,916</u> |
| Total liabilities and shareholders' equity | | <u>\$ 217,640</u> | <u>\$ 245,238</u> |

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

April 1, 2009

Date of approval of the
financial statements

CERAGON NETWORKS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

| | Note | Year ended December 31, | | |
|--|------|-------------------------|------------|------------|
| | | 2006 | 2007 | 2008 |
| Revenues | 11b | \$ 108,415 | \$ 161,888 | \$ 217,278 |
| Cost of revenues | | 80,776 | 103,406 | 144,607 |
| Gross profit | | 27,639 | 58,482 | 72,671 |
| Operating expenses: | | | | |
| Research and development | | 13,336 | 15,457 | 20,310 |
| Less - grants and participations | | 1,543 | - | - |
| Research and development, net | | 11,793 | 15,457 | 20,310 |
| Selling and marketing | | 17,420 | 25,344 | 32,252 |
| General and administrative | | 5,170 | 5,277 | 7,150 |
| Expense in respect of settlement reserve | | - | 450 | - |
| Total operating expenses | | 34,383 | 46,528 | 59,712 |
| Operating income (loss) | | (6,744) | 11,954 | 12,959 |
| Financial income, net | 12a | 1,284 | 1,182 | 2,184 |
| Income (loss) before taxes | | (5,460) | 13,136 | 15,143 |
| Tax benefit | | - | - | 10,834 |
| Net income (loss) | | \$ (5,460) | \$ 13,136 | \$ 25,977 |
| Net earnings (loss) per share: | 12b | | | |
| Basic net earnings (loss) per share | | \$ (0.20) | \$ 0.44 | \$ 0.70 |
| Diluted net earnings (loss) per share | | \$ (0.20) | \$ 0.41 | \$ 0.68 |

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

CERAGON NETWORKS LTD. AND SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except share and per share data)

| | Ordinary shares | Share capital | Additional paid-in capital | Treasury shares at cost | Deferred stock compensation | Accumulated other comprehensive income (loss) | Accumulated deficit | Total other comprehensive income (loss) | Total shareholders' equity |
|---|--------------------|------------------|----------------------------------|-------------------------------|-----------------------------------|---|------------------------|--|----------------------------------|
| Balance as of January 1, 2006 | 26,335,003 | \$ 65 | \$ 177,338 | \$ - | \$ (26) | \$ 51 | \$ (128,239) | | \$ 49,189 |
| Exercise of stock options | 1,101,087 | 3 | 2,104 | - | - | - | - | | 2,107 |
| Reversal of deferred stock compensation upon adoption of SFAS 123(R) | - | - | (26) | - | 26 | - | - | | - |
| Stock-based compensation expense | - | - | 1,712 | - | - | - | - | | 1,712 |
| Income tax benefit derived from exercise of employee stock options *) | - | - | - | - | - | - | - | \$ - | - |
| Comprehensive loss: | | | | | | | | | |
| Unrealized gain from hedging activities | - | - | - | - | - | 13 | - | 13 | 13 |
| Net loss | - | - | - | - | - | - | (5,460) | (5,460) | (5,460) |
| Total comprehensive loss | | | | | | | | \$ (5,447) | |
| Balance as of December 31, 2006 | 27,436,090 | 68 | 181,128 | - | - | 64 | (133,699) | | 47,561 |
| Issuance of shares, net of issuance expenses | 6,990,000 | 18 | 88,246 | - | - | - | - | | 88,264 |
| Exercise of stock options | 2,492,106 | 5 | 9,954 | - | - | - | - | | 9,959 |
| Stock-based compensation expense | - | - | 1,758 | - | - | - | - | | 1,758 |
| Income tax benefit derived from exercise of employee stock options *) | - | - | - | - | - | - | - | \$ - | - |
| Comprehensive income: | | | | | | | | | |
| Unrealized gain from hedging activities | - | - | - | - | - | 216 | - | 216 | 216 |
| Net income | - | - | - | - | - | - | 13,136 | 13,136 | 13,136 |
| Total comprehensive income | | | | | | | | \$ 13,352 | |
| Balance as of December 31, 2007 | 36,918,196 | 91 | 281,086 | - | - | 280 | (120,563) | | 160,894 |
| Income tax benefit derived from deductible issuance expenses | - | - | 803 | - | - | - | - | | 803 |
| Exercise of stock options | 168,308 | **) | 695 | - | - | - | - | | 695 |
| Purchase of treasury shares at cost | (1,499,803) | - | - | (7,923) | - | - | - | | (7,923) |
| Stock-based compensation expense | - | - | 2,557 | - | - | - | - | | 2,557 |
| Income tax benefit derived from exercise of employee stock options *) | - | - | - | - | - | - | - | \$ - | - |
| Comprehensive income: | | | | | | | | | |

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| | Ordinary shares | Share capital | Additional paid-in capital | Treasury shares at cost | Deferred stock compensation | Accumulated other comprehensive income (loss) | Accumulated deficit | Total other comprehensive income (loss) | Total shareholders' equity |
|--|--------------------|------------------|----------------------------------|-------------------------------|-----------------------------------|---|------------------------|--|----------------------------------|
| Unrealized loss from hedging activities, net of taxes | - | - | - | - | - | (87) | - | (87) | (87) |
| Net income | - | - | - | - | - | - | 25,977 | 25,977 | 25,977 |
| Total comprehensive income | | | | | | | | \$ 25,890 | |
| Balance as of December 31, 2008 | 35,586,701 | \$ 91 | \$ 285,141 | \$ (7,923) | \$ - | \$ 193 | \$ (94,586) | | \$ 182,916 |

*) The income tax benefit for the years ended December 31, 2006, 2007 and 2008 was \$ 524, \$ 1,673 and \$ 249, respectively, for which a valuation allowance was provided (see also Note 10f).

***) Represent an amount lower than \$1

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

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CERAGON NETWORKS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, | | |
|--|-------------------------|-----------|-----------|
| | 2006 | 2007 | 2008 |
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ (5,460) | \$ 13,136 | \$ 25,977 |
| Adjustments required to reconcile net income (loss) to net cash used in operating activities: | | | |
| Depreciation | 1,194 | 1,342 | 2,070 |
| Stock-based compensation expense | 1,712 | 1,758 | 2,557 |
| Gain from sale of property and equipment | (45) | (24) | - |
| Accrued severance pay, net | 533 | 203 | 564 |
| Increase in accrued interest on bank deposits | (89) | (317) | (330) |
| Accrued interest and amortization of premium on held-to-maturity marketable securities | 37 | (438) | 126 |
| Increase in trade receivables, net | (12,354) | (13,100) | (30,278) |
| Increase in other accounts receivable and prepaid expenses | (1,771) | (3,747) | (640) |
| Increase in inventories, net | (11,167) | (9,452) | (3,350) |
| Increase in trade payables | 9,765 | 4,194 | 13,922 |
| Increase (decrease) in deferred revenues | 283 | 2,963 | (816) |
| Increase in deferred tax asset | - | - | (11,353) |
| Increase (decrease) in other accounts payable and accrued expenses | 5,086 | 2,429 | (5,343) |
| Increase (decrease) in other long-term payables | 7,925 | (3,275) | (4,650) |

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| | <u>Year ended December 31,</u> | | |
|--|--------------------------------|----------------|-----------------|
| | <u>(4,351)</u> | <u>(4,328)</u> | <u>(11,544)</u> |
| Net cash used in operating activities | | | |
| <u>Cash flows from investing activities:</u> | | | |
| Purchase of property and equipment | (1,393) | (2,855) | (5,029) |
| Proceeds from sale of property and equipment | 48 | 25 | - |
| Investment in short and long-term bank deposits | (2,495) | (35,654) | (66,267) |
| Proceeds from maturities of short and long-term bank deposits | 3,586 | 6,181 | 61,376 |
| Investment in held-to-maturity marketable securities | (3,116) | (22,186) | (14,851) |
| Proceeds from maturities of held-to-maturity marketable securities | 5,469 | 8,638 | 13,500 |
| Net cash provided by (used in) investing activities | 2,099 | (45,851) | (11,271) |
| <u>Cash flows from financing activities:</u> | | | |
| Proceeds from issuance of shares, net of issuance costs | - | 88,700 | - |
| Purchase of treasury shares at cost | - | - | (7,923) |
| Payment of issuance costs | - | - | (383) |
| Proceeds from exercise of stock options | 2,107 | 9,959 | 695 |
| Net cash provided by (used in) financing activities | 2,107 | 98,659 | (7,611) |
| Increase (decrease) in cash and cash equivalents | (145) | 48,480 | (30,426) |
| Cash and cash equivalents at the beginning of the year | 10,315 | 10,170 | 58,650 |
| Cash and cash equivalents at the end of the year | \$ 10,170 | \$ 58,650 | \$ 28,224 |
| <u>Supplemental disclosures of non cash financing and investing activities:</u> | | | |
| Issuance costs | \$ - | \$ 436 | \$ - |
| Purchase of property and equipment | \$ - | \$ 275 | \$ 1,760 |
| Unrealized gain (loss) from hedging activities, net | \$ 13 | \$ 216 | \$ (87) |
| Deferred taxes due to deductible issuance costs | - | - | \$ 803 |
| <u>Supplemental disclosure of cash flow information:</u> | | | |
| Cash paid during the year for income taxes | \$ 212 | \$ 295 | \$ 536 |
| Cash paid during the year for interest | \$ - | \$ 518 | \$ 339 |

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

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands**NOTE 1: GENERAL**

Ceragon Networks Ltd. (the Company) is a leading provider of high capacity, LTE-Ready wireless backhaul solutions that enable wired and wireless service providers to deliver voice and premium data services, such as Internet browsing, music and video applications. The Company's wireless backhaul solutions use microwave technology to transfer large amounts of network traffic between base stations and the infrastructure at the core of the mobile network.

The Company sells its products through a direct sales force, systems integrators, distributors and original equipment manufacturers.

The Company has eleven wholly-owned subsidiaries in Brazil, France, Hong Kong, Singapore, Nigeria, India, Mexico, the Philippines, the United Kingdom, Australia and the United States. The subsidiaries provide marketing, distribution, sales and technical support to the Company's customers worldwide.

As to principal markets and major customers, see Note 11.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**a. Basis of presentation:**

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

b. Use of estimates:

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

c. Financial statements in U.S. dollars:

A majority of the revenues of the Company and certain of its subsidiaries are generated in U.S. dollars (dollars). In addition, a substantial portion of the Company's and certain of its subsidiaries' costs is incurred in dollars. Since management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate, the dollar is its functional and reporting currency. Accordingly, amounts in currencies other than U.S. dollars have been remeasured in accordance with Statement 52 of the Financial Accounting Standards Board (FASB), Foreign Currency Translation as follows:

Monetary balances at the exchange rate in effect on the balance sheet date.

Costs at the exchange rates in effect as of the date of recognition of the transaction.

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

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Management considers the non-U.S. subsidiaries to be a direct, integral extension of the parent company's operations. Accordingly, the functional currency of these subsidiaries is the dollar.

d. Principles of consolidation:

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

e. Cash equivalents:

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

f. Short-term and long-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months and up to one year. The short-term bank deposits are in U.S. dollars and bear interest at an average rate of 3.24%. The short-term bank deposits are presented at their cost, including accrued interest.

Long-term bank deposits are deposits with maturities of more than one year. The long-term deposits are in U.S. dollars and bear interest at an average rate of 3.90%. The long-term bank deposits are presented at their cost, including accrued interest.

g. Marketable securities:

The Company accounts for investments in marketable securities in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115).

Management determines the appropriate classification of its investments in marketable debt securities at the time of purchase and reevaluates such determinations at each balance sheet date. Marketable securities are classified as held-to-maturity as the Company has the positive intent and ability to hold the securities to maturity. Such marketable securities are stated at amortized cost plus accrued interest.

During the years ended December 31, 2007 and 2008, all securities were accounted for in accordance with SFAS 115 and were designated by the Company's management as held-to-maturity.

Amortization of premium and accretion of discounts, as well as interest, are included in financial income, net.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company periodically reviews its marketable securities for impairment. If the Company concludes that any of these investments are impaired, the Company determines whether such impairment is other-than-temporary as defined under the FASB Staff Position (FSP) 115-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. Factors considered to make such a determination include intent and ability to hold the investment for a period of time sufficient for any anticipated recovery in market value, the length of time and extent to which the fair value has been less than its cost basis, the credit ratings of the securities, the nature of underlying collateral as applicable and the financial condition and near-term prospects of the issuer. If any impairment is considered other-than-temporary, The Company will write down the asset to its fair value and take a corresponding charge to the consolidated statements of operations. During 2006, 2007 and 2008 no other-than-temporary impairments were identified.

h. Inventories:

Inventories are stated at the lower of cost or market value. Inventory provisions are provided to cover risks arising from excess and slow-moving items, technological obsolescence.

Cost is determined for all types of inventory using the moving average cost method plus indirect costs.

i. 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:

| | % |
|---|---|
| Computers, manufacturing and peripheral equipment | 15 - 33 |
| Office furniture and equipment | 7 |
| Leasehold improvements | Over the shorter of the term of the lease or useful life of the asset |

j. Impairment of long-lived assets:

The Company's and its subsidiaries' long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. During 2006, 2007 and 2008, no impairment losses have been identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Income taxes:

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The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes (SFAS No. 109). This Statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between the financial reporting and tax bases of assets and liabilities and for carryforward losses deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company elected to classify interest expenses and penalties recognized in the financial statements as income taxes. For the years 2007 and 2008 no penalties were recognized.

1. Revenue recognition:

The Company and its subsidiaries generate revenues from selling products to end users, distributors, system integrators and original equipment manufacturers (OEM).

Revenues from product sales are recognized in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB 104), when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no future obligation exists and collectibility is probable.

The Company generally does not grant a right of return to its customers. When a right of return exists, the Company creates a provision for returns according to SFAS 48, Revenue Recognition When Right of Return Exists .

When sale arrangements include a customer acceptance provision, revenue is recognized when the Company has demonstrated that the criteria specified in the acceptance provision have been satisfied.

Revenue from certain arrangements includes multiple elements which are the sale of products and post delivery installation services that are not essential to the functionality of the equipment. The Company's accounting policy complies with the requirements set forth in Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21), relating to the separation of multiple deliverables into individual accounting units and revenue from such deliverables is recognized under SAB 104.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In arrangements which include multiple elements, the Company considers the sale of equipment and its installation to be two separate units of accounting in the arrangement, since the installation is not essential to the functionality of the equipment, the equipment has value to the customer on a standalone basis, and fair value of the installation services exists. In such arrangement, revenues from the sale of equipments are recognized upon delivery, if all other revenue recognition criteria are met and the Company defers the fair value of the installation service (but not less than the amount contingent upon completion of installation, if any) to the period in which such installation occurs.

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To assess the probability of collection for revenue recognition purposes, the Company analyzes historical collection experience, current economic trends and the financial position of its customers. On the basis of these criteria, the Company decides whether revenue recognition should be deferred and recognized on a cash basis.

The Company also applies Emerging Issues Task Force (EITF) 99-19, Reporting Revenues Gross as a Principal versus Net as an Agent (EITF 99-19), regarding arrangements where the Company also provides third party equipment and reports revenues gross as a principal.

Deferred revenues include amounts received from customers for which revenue has not been recognized.

m. Research and development costs:

Research and development costs, net of grants received, are charged to the statement of operations as incurred.

n. Royalty-bearing grants:

Royalty-bearing grants from the Government of Israel for funding approved research and development projects are recognized at the time the Company was entitled to such grants, on the basis of the costs incurred and included as a reduction in research and development costs. Such grants were recorded as a reduction in research and development costs since when received it was not probable that the grants will be repaid (see also Notes 7 and 8a).

o. Derivative instruments:

The Company has instituted a foreign currency cash flow hedging program using foreign currency forward and option contracts (derivative instruments) in order to hedge the exposure to variability in expected future cash flows resulting from changes in related foreign currency exchange rates. These transactions are designated as cash flow hedges, as defined by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133).

SFAS 133 requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The Company measured the fair value of the contracts in accordance with SFAS 157, *Fair Value Measurements* (SFAS 157) at level 2 (see also Note 2t). The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss), net of taxes and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The effective portion of the derivative's change in fair value is recognized in earnings.

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The Company's cash flow hedging strategy is to hedge against the risk of overall changes in cash flows resulting from forecasted foreign currency salary payments during the year. The Company hedges portions of its forecasted expenses denominated in NIS with forward exchange contracts and options. These forward exchange contracts and options are designated as cash flow hedges, as defined by SFAS No. 133 and Derivative Implementation Group No. G20, "Cash Flow Hedges: Assessing and Measuring the Effectiveness of a Purchased option Used in a Cash Flow Hedge" (DIG 20) and are all effective.

Fair value hedging strategy The Company enters into forward exchange contracts to hedge a portion of its certain monetary items in the balance sheet, such as trade receivables and trade payables denominated in foreign currencies for a period of up to three months. The purpose of the Company's foreign currency hedging activities is to protect the fair value due to foreign exchange rates.

The Company recognized net gain from derivative instruments of \$ 188, \$ 840 and \$ 1,440 during the years ended December 31, 2006, 2007 and 2008, respectively. The amounts of \$ 264, \$ 375 and \$ 779 were offset against operating expenses during the years ended December 31, 2006, 2007 and 2008, respectively, and amounts of \$ (76), \$ 465 and \$ 661 were included in financial income, net during the years ended December 31, 2006, 2007 and 2008, respectively.

The balance in accumulated other comprehensive income related to derivative instruments as of December 31, 2008 is expected to be recognized in the statement of operations over the next twelve months.

p. **Concentrations of credit risk:**

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

The majority of the Company's cash and cash equivalents and short-term and long-term bank deposits are invested in U.S. dollar instruments with major banks worldwide. Such cash and cash equivalents and deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally, these cash and cash equivalents and deposits may be redeemed upon demand and, therefore, bear minimal risk.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's marketable securities include securities issued by U.S. government and agencies and debentures of corporations. The Company's investment policy, approved by the Investment Committee, limits the amount the Company may invest in any one type of investment or issuer, thereby reducing credit risk concentrations.

The Company's trade receivables are derived from sales to customers located in North America, Europe, the Middle East, Africa, Asia-Pacific and Latin America. The Company and its subsidiaries generally do not require collateral; however, in certain circumstances, the Company and its subsidiaries may require letters of credit, additional guarantees or advance payments. The Company and its subsidiaries perform ongoing credit evaluations of their customers and insure certain trade receivables under credit insurance policies. An allowance for doubtful accounts is determined with respect to a general reserve and specific receivables, of which the collection may be doubtful. The Company charges off receivables when they are deemed uncollectible.

Changes in the Company's allowance for doubtful accounts are as follows:

**Allowance for
doubtful
Accounts**

| | <u>Allowance for doubtful Accounts</u> |
|---------------------------------|--|
| Balance as of January 1, 2006 | \$ 518 |
| Provision | 457 |
| Write-off | (133) |
| | <hr/> |
| Balance as of December 31, 2006 | 842 |
| Provision | 437 |
| | <hr/> |
| Balance as of December 31, 2007 | 1,279 |
| Provision | 1,238 |
| | <hr/> |
| Balance as of December 31, 2008 | \$ 2,517 |
| | <hr/> |

q. Transfers of Financial Assets

During the year ended December 31, 2008 the Company entered into a transaction for the sale of a letter of credit received from a customer of the Company to a foreign financial institution (control and risk were fully transferred) in a total amount of \$ 2,795 and accounted for those transactions according to SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140).

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

r. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)) which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS No. 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), for periods beginning in fiscal year 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R).

Effective January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective transition method. Under that transition method, compensation cost recognized in the years ended December 31, 2006, 2007 and 2008, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost 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). Results for prior periods have not been restated, in accordance with the modified prospective transition method.

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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 statements of operations.

The Company estimates the fair value of stock options granted under SFAS No. 123R using the binomial model with the following weighted-average assumptions for 2006, 2007 and 2008:

| | December 31, | | |
|-------------------------|---------------|---------------|-------------|
| | 2006 | 2007 | 2008 |
| Dividend yield | 0 | 0 | 0 |
| Volatility | 35.07%-53.19% | 35.97%-62.75% | 50%-79% |
| Risk free interest | 4.28%-5.41% | 2.77%-5.20% | 0.37%-5.17% |
| Early exercise multiple | 2.36-3.10 | 2.36-3.10 | 2.05-3.10 |

Risk-free interest rates are based on the yield from U.S. Treasury zero-coupon bonds with a term equivalent to the contractual life of the options; volatility of price of the Company's shares based upon actual historical stock price movements. Early exercise multiple is based on actual historical exercise activity. The expected term of the options granted is derived from output of the option valuation model and represents the period of time that options granted are expected to be outstanding.

The Company recognizes compensation expense using the accelerated method for all awards ultimately expected to vest. Estimated forfeitures are based on historical pre-vesting forfeitures and on management's estimates. SFAS 123(R) requires forfeitures to be estimated and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Severance pay:

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

The severance pay fund includes the deposited funds and accumulated adjustments to the Israeli Consumer Price Index up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds in insurance policies, is based on the cash surrendered value of these policies, and includes profits / losses.

Severance expense for the years ended December 31, 2006, 2007 and 2008, amounted to approximately \$ 1,281, \$ 1,168 and \$ 1,760, respectively.

t. Fair value of financial instruments:

The following methods and assumptions were used by the Company and its subsidiaries in estimating their fair value disclosures for financial instruments:

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

The fair value of the Company's long-term bank deposits is estimated by discounting the future cash flows using the current interest rates for long-term bank deposit of similar terms and maturities. The carrying amount of the long-term bank deposit does not significantly differ from its fair value.

The fair value of marketable securities is based on quoted market prices.

Effective January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements* and, effective October 10, 2008, adopted FSP No. SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, except as it applies to the nonfinancial assets and nonfinancial liabilities subject to FSP 157-2. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

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

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

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

u. Comprehensive income (loss):

The Company accounts for comprehensive income (loss) in accordance with SFAS No. 130, *Reporting Comprehensive Income*. This statement establishes standards for the reporting and display of comprehensive income (loss) and its components in a full set of general purpose financial statements. Comprehensive income (loss) generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. The Company determined that its items of other comprehensive income (loss) relates to gain and loss on hedging derivative instruments.

v. Warranty costs:

The Company generally offers a standard limited warranty, including parts and labor for periods of 12 to 36 months for its products. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Warranty expenses (income) for the years ended December 31, 2006, 2007 and 2008 were approximately \$ 352, \$ 530 and \$ (507), respectively.

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

Basic net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, Earnings Per Share (SFAS 128).

The total weighted average number of shares related to the outstanding options excluded from the calculations of diluted net earnings (loss) per share due to their anti-dilutive effect was 3,364,631, 345,014 and 1,213,564 for the years ended December 31, 2006, 2007 and 2008, respectively.

x. Treasury shares

The Company repurchases its Ordinary shares on the open-market and holds such shares as Treasury shares. The Company presents the cost of repurchased treasury shares as a reduction of shareholders' equity.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

y. Reclassification:

Certain prior period amounts have been reclassified to conform to the current year's presentation.

z. Impact of recently issued Accounting Standards:

In December 2007, the FASB issued SFAS No. 141 (Revised) *Business Combinations*. SFAS 141 (Revised) replaces SFAS 141 *Business Combination* and 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 noncontrolling 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 statements to evaluate the nature and financial effects of the business combination. The guidance will become effective for the fiscal year beginning after December 15, 2008. The Company does not expect that SFAS 141 (Revised) will have any impact on the Company's historical financial statements upon adoption.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS 160 amends Accounting Research Bulletin 51, *Consolidated Financial Statements*, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect that SFAS 160 will have any impact on the Company's historical financial statements upon adoption.

In February 2008, the FASB issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP 140-3). FSP 140-3 concludes that a transferor and transferee should not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic

purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. FSP 140-3 is effective for financial statements issued for fiscal years beginning on or after November 15, 2008, and interim periods within those fiscal years. The adoption of FSP 140-3 is not expected to have a material effect on the Company's results of operations or financial position.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In February 2008, the FASB issued FSP No. FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13", and FSP No. FAS 157-2, "Effective Date of FASB Statement No. 157". Collectively, the Staff Positions defer the effective date of Statement 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of Statement 157.

In March 2008, the FASB issued Statement 161 "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161) an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. The Company does not expect the adoption of SFAS 161 to have a material impact on its financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 became effective on November 2008. The adoption of this statement is not expected to have a material effect on the Company's financial statements.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 3: MARKETABLE SECURITIES

The following is a summary of held-to-maturity securities:

December 31,

2007

2008

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December 31,

| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Fair market value | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair market value |
|------------------------------------|------------------|------------------------|-------------------------|-------------------|------------------|------------------------|-------------------------|-------------------|
| Held-to-maturity: | | | | | | | | |
| U.S. government and agencies debts | \$ 1,999 | \$ 4 | \$ - | \$ 2,003 | \$ 10,152 | \$ 23 | \$ - | \$ 10,175 |
| Corporate debentures | 23,065 | - | (426) | 22,639 | 16,137 | - | (429) | 15,708 |
| | <u>\$ 25,064</u> | <u>\$ 4</u> | <u>\$ (426)</u> | <u>\$ 24,642</u> | <u>\$ 26,289</u> | <u>\$ 23</u> | <u>\$ (429)</u> | <u>\$ 25,883</u> |

The unrealized losses and gains in the Company's investments in held-to-maturity marketable securities were mainly caused by interest rate changes. The contractual cash flows of these investments are either guaranteed by the U.S. government or an agency of the U.S. government or were issued by highly rated corporations and other governments. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment.

Based on the ability and intent of the Company to hold these investments until maturity, the bonds were not considered to be other than temporarily impaired at December 31, 2008.

Out of the unrealized losses as of December 31, 2007 and 2008, \$ 88 and \$ 149 respectively, of losses are outstanding over 12 month period. The fair value of these marketable securities which bear losses over 12 twelve month period is \$ 3,613 and \$ 8,490, respectively.

Aggregate maturities of held-to-maturity securities for years subsequent to December 31, 2008 are:

| | Amortized cost | Fair market value |
|---|------------------|-------------------|
| Held-to-maturity: | | |
| 2009 (short-term marketable securities) | \$ 2,187 | \$ 1,715 |
| 2010 | 13,341 | 13,233 |
| 2011 | 10,761 | 10,935 |
| | <u>\$ 26,289</u> | <u>\$ 25,883</u> |

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 4: OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

December 31,

| | December 31, | |
|--|---------------|---------------|
| | 2007 | 2008 |
| Government authorities | \$ 2,273 | \$ 3,101 |
| Prepaid expenses | 4,447 | 6,863 |
| Receivables related to unrecognized sold inventory | 3,353 | 682 |
| Other | 815 | 862 |
| | <u>10,888</u> | <u>11,508</u> |

NOTE 5: INVENTORIES

| | December 31, | |
|-------------------|---------------|---------------|
| | 2007 | 2008 |
| Raw materials | \$ 3,872 | \$ 6,453 |
| Work in progress | 4,712 | 1,290 |
| Finished products | 28,179 | 32,370 |
| | <u>36,763</u> | <u>40,113</u> |

Finished products include products shipped to customers for which revenues were not recognized during the year. Such products amounted to \$ 10,254 and \$ 15,537 at December 31, 2007 and 2008, respectively.

During 2006, 2007 and 2008, the Company recorded inventory write-offs for excess inventory and a provision for slow moving inventory in a total amount of \$ 716, \$ 2,353 and \$ 3,119, respectively.

NOTE 6: PROPERTY AND EQUIPMENT, NET

| | December 31, | |
|---|---------------|---------------|
| | 2007 | 2008 |
| Cost: | | |
| Computers, manufacturing and peripheral equipment | \$ 12,512 | \$ 18,791 |
| Office furniture and equipment | 1,345 | 1,386 |
| Leasehold improvements | 661 | 792 |
| | <u>14,518</u> | <u>20,969</u> |
| Accumulated depreciation: | | |
| Computers, manufacturing and peripheral equipment | 8,674 | 10,534 |
| Office furniture and equipment | 943 | 994 |
| Leasehold improvements | 454 | 550 |
| | <u>10,071</u> | <u>12,078</u> |

| | December 31, | |
|------------------|--------------|----------|
| | _____ | _____ |
| Depreciated cost | \$ 4,447 | \$ 8,891 |

Depreciation expenses for the years ended December 31, 2006, 2007 and 2008 were \$ 1,194, \$ 1,342 and \$ 2,070, respectively.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 7: OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

| | December 31, | |
|---|--------------|----------|
| | 2007 | 2008 |
| | _____ | _____ |
| Employees and payroll accruals | \$ 7,040 | \$ 6,135 |
| Accrued expenses | 555 | 468 |
| Royalties to Government authorities (Note 8a) | 4,341 | - |
| Provision for warranty costs | 1,665 | 1,158 |
| Other | 166 | 280 |
| | _____ | _____ |
| | \$ 13,767 | \$ 8,041 |
| | _____ | _____ |

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalties to the Office of the Chief Scientist:

The Company participated in programs sponsored by the Israeli Government for the support of research and development activities. Through December 31, 2006, the Company had obtained grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor (the OCS) aggregating to \$ 18,542 for certain of the Company's research and development projects. The Company was obligated to pay royalties to the OCS, amounting to 3%-3.5% of the sales of the products and other related revenues generated from such projects, equal 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 was contingent on actual sales of the products and in the absence of such sales, no payment is required.

In December 2006, the Company entered into an agreement with the OCS to conclude its research and development grant programs sponsored by the OCS. Under the agreement and as of December 31, 2006, the Company was obligated to repay the OCS approximately \$ 11,887. The payment was agreed to be made in six semiannual installments commencing 2007 through 2009. The outstanding obligation was linked to the change in Israel's Consumer Price Index and bore interest. In addition, the Company was required to continue reporting to the OCS regarding its sales each quarter until the obligation is fully paid.

During the second quarter of 2008 an amount of approximately \$ 7,360 was paid to the OCS to retire the remaining outstanding debt from the arrangement reached with the OCS in December 2006.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b. Lease commitments:

The Company and its subsidiaries lease their facilities and motor vehicles under various operating lease agreements that expire on various dates. Aggregate minimum rental commitments under non-cancelable leases at December 31, 2008, are as follows:

| Year ended December 31, | Facilities | Motor vehicles | Total |
|-------------------------|------------|-------------------|----------|
| 2009 | \$ 1,812 | \$ 1,017 | \$ 2,829 |
| 2010 | 1,646 | 902 | 2,548 |
| 2011 | 444 | 736 | 1,180 |
| 2012 | 424 | 372 | 796 |
| 2013 | 245 | - | 245 |
| 2014 and thereafter | 276 | - | 276 |
| | \$ 4,847 | \$ 3,027 | \$ 7,874 |

Expenses for lease of facilities for the years ended December 31, 2006, 2007 and 2008 were approximately \$ 1,115, \$ 1,166 and \$ 1,928, respectively (see also Note 13).

Expenses for the lease of motor vehicles for the years ended December 31, 2006, 2007 and 2008 were approximately \$ 781, \$ 905 and \$ 1,042, respectively.

c. Charges and guarantees:

As of December 31, 2008, the Company provided bank guarantees in an aggregate amount of \$ 7,121 with respect to tender offer guarantees and performance guarantees to its customers.

d. Potential claim:

1. NEC Corporation, or NEC, has asserted that the Company has been using its intellectual property in certain of the Company's products. The Company entered into discussions with NEC with respect to NEC's allegation. On August 8, 2007, in the framework of this discussion, the Company made a settlement offer to NEC in order to fully resolve NEC's allegations. This settlement offer included a lump sum payment of \$ 450 and certain cross-licensing arrangements in consideration for a release of any potential claim of infringement relating to NEC's allegations. The Company believes that it does not infringe any valid claim of NEC patents at issue, and if any of these patents were to be tried, a competent judge or jury would not find the Company liable to NEC for patent infringement damages. However, in the light of the Company's offer made to NEC a provision of \$ 450 is included in the consolidated financial statements as of December 31, 2008.

2.

In December 2008, the Company received a claim from a certain company stating that in its opinion the Company requires a license to one of its patents. The Company, based on available information, believes it does not infringe the patent at issue. However, the Company is not able to estimate the outcome of such claim. Accordingly, no provision was accrued in the financial statements as of December 31, 2008.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 9: SHAREHOLDERS EQUITY

The Ordinary shares of the Company are traded on Nasdaq Global Market and on the Tel Aviv Stock Exchange, under the symbol CRNT .

a. General:

The ordinary shares entitle their holders to receive notice to participate and vote in general meetings of the Company, the right to share in distributions upon liquidation of the Company, and to receive dividends, if declared.

b. Issuance of shares:

In November 2007, the Company issued 6,990,000 ordinary shares in a follow-on equity offering on Nasdaq Global Market. The offering included 6,000,000 ordinary shares issued to public at price of \$ 13.5 per share and additional 990,000 ordinary shares issued to the underwriters. Total proceeds net of issuance costs of approximately \$ 6,101, were \$ 88,264.

c. Stock options plans:

1. Under the Company's 1996 Key Employee Share Incentive Plan, the 1997 Affiliate Employees Stock Option Plan (the Plans), and the 2003 Share Option Plan (the 2003 Plan), options may be granted to officers, directors, employees and consultants of the Company or its subsidiaries. The options vest primarily over one to five years. The options expire ten years from the date of grant.

In light of the adoption of the 2003 Plan, the Company ceased granting options under the 1996 Key Employee Share Incentive Plan as of December 31, 2002 and under the 1997 Affiliate Employee Share Option Plan as of February 2003 although options granted under the 1996 Key Employee Share Incentive Plan or 1997 Affiliate Share Option Plan before such dates are still valid, subject to the respective Plans.

2. Upon adoption of its share option plans, the Company reserved for issuance 14,273,188 ordinary shares in accordance with the respective terms thereof. As of December 31, 2008, the Company still has 188,482 Ordinary shares available for future grant under the plans. Any options, which are canceled or forfeited before the expiration date, become available for future grants.
3. During 2008, the Company's board of directors approved a stock option exchange program for certain share options that were granted during 2007 and 2008 until the date of the exchange program (the Options). Under the exchange program, the Company offered its employees the opportunity to exchange the Options, with new options to be granted to them on the date of the exchange. These new options would have a new exercise price which would be equal to the closing price of the Company's Ordinary shares on the NASDAQ Global Market on the date the new options were granted. As a result of the exchange, on November 6, 2008, 391,000 options with an exercise price ranging between \$ 7 to 17 per share were cancelled and 391,000 options with an exercise price of \$ 5.65 per share were granted. According to the program, those new options will vest over a period of 4 years commencing the date of the exchange.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 9: SHAREHOLDERS EQUITY (Cont.)

The Company accounted for the exchange of options under the provisions of SFAS 123(R) which indicates that a modification to the terms of an award should be treated as an exchange of the original award for a new award with total compensation cost equal to the grant-date fair value of the original award plus the incremental value of the modification to the award. Under Statement 123(R), the calculation of the incremental value is based on the excess of the fair value of the new (modified) award based on current circumstances over the fair value of the original option measured immediately before its terms are modified based on current circumstances. As a result of the modification, the Company will record additional expense in the amount of \$ 275 to be recognized over new requisite service period ending 2012. In the year ended on December 31, 2008, the Company recorded an additional expense of \$ 25 with respect to this exchange. The remaining compensation expense of the original awards shall be expense over the new vesting period of 4 years.

4. The following is a summary of the Company's stock options granted among the various plans:

| | Year ended December 31, 2008 | | | |
|--|------------------------------|---------------------------------|--|---------------------------|
| | Number of options | Weighted average exercise price | Weighted average remaining contractual term (in years) | Aggregate intrinsic value |
| Outstanding at beginning of year | 4,623,722 | \$ 5.12*) | | |
| Granted | 1,061,500 | \$ 6.91 | | |
| Exercised | (168,308) | \$ 4.13 | | |
| Forfeited | (124,413) | \$ 7.93 | | |
| Outstanding at end of the year | 5,392,501 | \$ 5.44 | 6.73 | \$ 2,855 |
| Options exercisable at end of the year | 3,148,211 | \$ 4.93 | 5.30 | \$ 2,538 |
| Vested and expected to vest | 5,082,180 | \$ 5.40 | 6.73 | \$ 2,818 |

*) 304,000 options from beginning of year balance were repriced.

The Company's options are generally granted at exercise prices which are equal to the market value of the Ordinary shares at the grant date. The weighted average grant date fair values of the options granted during 2006, 2007 and 2008 were \$ 1.31, \$ 4.02 and \$ 4.12 respectively.

The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of fiscal 2008 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, 2008. This amount is impacted by the changes, in the fair market value of the Company's shares. Total intrinsic value of options exercised during the years ended December 31, 2007 and 2008 were \$ 14,910 and \$ 693, respectively. As of December 31, 2008, there was \$ 4,068 of total unrecognized compensation

cost related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of one year.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 9: SHAREHOLDERS' EQUITY (Cont.)

The total equity-based compensation expense related to all of the Company's equity-based awards, recognized for the years ended December 31, 2006, 2007 and 2008, was comprised as follows:

| | Year ended December 31, | | |
|---|-------------------------|----------|----------|
| | 2006 | 2007 | 2008 |
| Cost of revenues | \$ 164 | \$ 126 | \$ 257 |
| Research and development, net | 310 | 293 | 586 |
| Selling and marketing | 471 | 748 | 1,007 |
| General and administrative | 767 | 591 | 707 |
| | <hr/> | <hr/> | <hr/> |
| Total stock-based compensation expenses | \$ 1,712 | \$ 1,758 | \$ 2,557 |

d. Treasury shares:

In October 2008, the Company initiated a share repurchase program, under which, the Company is authorized to purchase its outstanding Ordinary shares up to aggregate value of \$20,000. The purchases may be performed in the open market or in negotiated or block transactions, all subject to regulatory requirements. As of December 31, 2008, the Company had purchased 1,499,803 of its outstanding Ordinary shares, at a weighted average price per share of \$5.28, for the total consideration of approximately \$7,923.

e. Dividends:

In the event that cash dividends are declared in the future, such dividends will be paid in NIS or in foreign currency subject to any statutory limitations. The Company does not intend to pay cash dividends in the foreseeable future.

NOTE 10: TAXES ON INCOME

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

The Company currently qualifies as an industrial company under the above law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation of machinery and equipment, and the right to claim public issuance expenses over three years, as a deduction for tax purposes.

b. Reduction in Israeli tax rates:

On July 25, 2005, the Israeli Parliament passed the Law for the Amendment of the Income Tax Ordinance (No.147 and Temporary Order), 2005 (the Amendment).

Inter alia, the Amendment provides for a gradual reduction in the statutory corporate tax rate in the following manner: 2008 27%, 2009 26% and 2010 and thereafter 25%. Furthermore, from 2010, upon reduction of the corporate tax rate to 25%, real capital gains will be subject to tax of 25%.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10: TAXES ON INCOME (Cont.)

c. Measurement of taxable income:

The Company has elected to file its tax return under the Israeli Income Tax Regulations 1986 (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income). Accordingly, results of operation in Israel are measured in terms of earnings in U.S. dollar.

d. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the Capital Investment Law):

The Company's production facilities have been granted an Approved Enterprise status under the Capital Investments Law currently under three separate investment programs. Pursuant to the Capital Investments Law, the Company has elected the alternative benefits track and has waived Government grants in return for a tax exemption.

The Company is also a foreign investors company, as defined by the Capital Investments Law, and, as such, is entitled to a 10-year period of benefits and may be entitled to reduced tax rates of between 10% to 25% (depending on the percentage of foreign ownership in each tax year).

On April 1, 2005, an amendment to the Capital Investments Law came into effect (the CIL Amendment) and has significantly changed the provisions of the Capital Investments Law. The CIL Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a Beneficiary Enterprise, such as provisions generally requiring that at least 25% of the Beneficiary Enterprise's income will be derived from export. Additionally, the CIL Amendment enacted major changes in the manner in which tax benefits are awarded under the Capital Investments Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. However, the Capital Investments Law provides that terms and benefits included in any letter 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 Enterprises will generally not be subject to the provisions of the Amendment.

The Company has three capital investment programs that have been granted Approved Enterprise status, under the Capital Investments Law (The Approved Programs) and a fourth program under Beneficiary Enterprise status pursuant to the CIL Amendment (The Beneficiary Program). Pursuant to the Beneficiary and Approved programs, the Company is entitled to a tax benefit period of seven to ten years on income derived from these programs, as follows: a full income tax exemption for the first two years and a reduced income tax rate of 10% to 25% for the remaining benefit period. The benefit period commences in the first year the Company reports taxable income after utilization of all net operating losses. The period of benefits for all these investment programs has not yet commenced, since the Company has not yet reported taxable income.

The period of tax benefits, detailed above (except for the first two years in which the Company is tax exempt), is subject to a limit of 12 years from the commencement of production, or 14 years from the approval date, whichever is earlier.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10: TAXES ON INCOME (Cont.)

The entitlement to the above benefits is subject to the Company's fulfilling the conditions stipulated by the Encouragement of Investments Law, regulations published thereunder and the letters of approval for the specific investments in Approved Enterprises. In the event of failure to comply with these conditions, the benefits may be cancelled and the Company may be required to refund the amount of the benefits, in whole or in part, linked to the CPI and including interest.

In the event of a distribution of such tax-exempt income including, among other things, a cash dividend, the Company will be required to pay tax at the rate of 10% to 25% on the gross amount of the dividend distributed. In addition, these dividends will be subject to a 15% withholding tax.

As a result of the CIL Amendment, among others, tax-exempt income generated under the provisions of the new law, will subject the Company to taxes upon distribution or liquidation and the Company may be required to record a deferred tax liability with respect to such tax-exempt income.

The Company's Board of Directors has determined that it will not distribute any amounts of its undistributed tax-exempt income as dividend. The Company intends to reinvest its tax-exempt income and not to distribute such income as a dividend. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Programs or Beneficiary Program as the undistributed tax-exempt income is essentially permanent in duration.

As of December 31, 2008, the Company did not generate income under the provisions of the Capital Investment Law and the CIL Amendment.

The Capital Investments Law also grants entitlement to claim accelerated depreciation on equipment used by the Approved Enterprise or the Beneficiary Enterprise during the first five tax years during which the equipment is used.

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

- e. The income tax expense (benefit) for the years ended December 31, 2006, 2007 and 2008 consisted of the following:

| | Year ended December 31, | | |
|-------------------|-------------------------|------|-------------|
| | 2006 | 2007 | 2008 |
| Current | \$ - | \$ - | \$ 519 |
| Deferred | - | - | (11,353) |
| | \$ - | \$ - | \$ (10,834) |
| Domestic (Israel) | \$ - | \$ - | \$ (11,212) |
| Foreign | - | - | 378 |
| | \$ - | \$ - | \$ (10,834) |

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10: TAXES ON INCOME (Cont.)

f. 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 tax assets and liabilities are as follows:

| | December 31, | |
|--|--------------|-----------|
| | 2007 | 2008 |
| Deferred tax assets: | | |
| Net operating loss carry forward *) | \$ 20,705 | \$ 15,694 |
| Temporary differences relating to reserve and allowances | 6,207 | 6,837 |
| Net deferred tax asset before valuation allowance | 26,912 | 22,531 |
| Valuation allowance | (26,912) | (10,442) |
| Total net deferred tax asset | \$ - | \$ 12,089 |

*) Including deferred taxes on losses for Israeli income tax purposes for 2007 and 2008, derived from the exercise of employee stock options in the amount of \$6,246 and \$843, respectively. The benefit derived from the exercise of employee stock options was not recorded through additional paid-in capital as required under FAS 123(R) since a valuation allowance was provided in this respect. As a result, there is no impact on the Company's shareholders' equity and on the deferred taxes for each of the years presented.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and net operating losses are utilized. Based on consideration of these factors, the Company recorded a valuation allowance amounting \$26,912 and \$ 10,442 at December 31, 2007 and 2008, respectively.

g. Net operating loss carryforward:

The Company has accumulated losses for Israeli income tax purposes as of December 31, 2008 in the amount of approximately \$ 45,684. These losses may be carried forward and offset against taxable income in the future for an indefinite period.

As of December 31, 2008, the Company's U.S. subsidiary had a U.S. federal net operating loss carryforward of approximately \$ 9,672 that can be carried forward and offset against taxable income and that expires during the years 2019 to 2026. Utilization of U.S. net operating losses may be subject to substantial annual limitations due to the change in ownership provisions of the Internal Revenue Code of 1986 and similar state law provisions. The annual limitations may result in the expiration of net operating losses before utilization.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10: TAXES ON INCOME (Cont.)

h. Income (loss) before taxes is comprised as follows:

| | Year ended December 31, | | |
|----------|-------------------------|------------------|------------------|
| | 2006 | 2007 | 2008 |
| Domestic | \$ (2,000) | \$ 11,621 | \$ 15,114 |
| Foreign | (3,460) | 1,515 | 29 |
| | <u>\$ (5,460)</u> | <u>\$ 13,136</u> | <u>\$ 15,143</u> |

i. Reconciliation of the theoretical tax expense to the actual tax expense:

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

| | Year ended December 31, | | |
|---|-------------------------|------------------|--------------------|
| | 2006 | 2007 | 2008 |
| Income (loss) before taxes as reported in the consolidated statements of operations | <u>\$ (5,460)</u> | <u>\$ 13,136</u> | <u>\$ 15,143</u> |
| Statutory tax rate | <u>31%</u> | <u>29%</u> | <u>27%</u> |
| Theoretical tax expenses on the above amount at the Israeli statutory tax rate | \$ (1,693) | \$ 3,809 | \$ 4,089 |
| Non-deductible expenses | 132 | 142 | 526 |
| Non-deductible expenses related to employee stock options | 531 | 510 | 691 |
| Deferred taxes on losses (utilization of losses) and temporary differences for which a valuation allowance was provided | 939 | (4,714) | (16,470) |
| Other | 91 | 253 | 330 |
| Actual tax benefit | <u>\$ -</u> | <u>\$ -</u> | <u>\$ (10,834)</u> |

- j. Effective January 1, 2007, the Company adopted the provisions of FIN 48. The balance for unrecognized tax benefit for tax positions which are uncertain of being sustained at December 31, and 2007 and 2008 is in the amount of \$ 0 and \$ 141, respectively.

The Company and its subsidiaries file income tax rerun in Israel, the United States and other various jurisdictions. The Company and its subsidiaries are routinely examined by various taxing authorities. The Israeli Tax Authorities are currently assessing income tax returns of the Company for the tax years 2003 through 2006. There are tax years which remain subject to examination in various other jurisdictions.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands**NOTE 11: SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION**

- a. The Company applies SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). The Company operates in one reportable segment (see Note 1 for a brief description of the Company s business). The total revenues are attributed to geographic areas based on the location of the end customer.
- b. The following presents total revenues for the years ended December 31, 2006, 2007 and 2008 and long-lived assets as of December 31, 2006, 2007 and 2008:

| | Year ended December 31, | | |
|--|-------------------------|-------------------|-------------------|
| | 2006 | 2007 | 2008 |
| Revenues from sales to unaffiliated customers: | | | |
| Asia-Pacific | \$ 32,358 | \$ 68,387 | \$ 113,004 |
| Europe, Middle East and Africa | 41,149 | 52,121 | 67,933 |
| North America | 28,162 | 34,438 | 18,772 |
| Latin America | 6,746 | 6,942 | 17,569 |
| | <u>\$ 108,415</u> | <u>\$ 161,888</u> | <u>\$ 217,278</u> |
| Property and equipment, net, by geographic areas: | | | |
| Israel | \$ 2,339 | \$ 4,094 | \$ 8,157 |
| Others | 321 | 353 | 734 |
| | <u>\$ 2,660</u> | <u>\$ 4,447</u> | <u>\$ 8,891</u> |

- c. For the years ended December 31, 2006, 2007 and 2008, one customer accounted for approximately 17%, 10% and 24%, respectively, of the Company s revenues for that year.

CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 12: SELECTED STATEMENTS OF OPERATIONS DATA

a. Financial income, net:

| | Year ended December 31, | | |
|---|-------------------------|-----------------|-----------------|
| | 2006 | 2007 | 2008 |
| Financial income: | | | |
| Interest on marketable securities and bank deposits | \$ 1,044 | \$ 1,652 | \$ 3,780 |
| Foreign currency translation differences | 311 | 292 | 11 |
| | <u>1,355</u> | <u>1,944</u> | <u>3,791</u> |
| Financial expenses: | | | |
| Bank charges | (71) | (213) | (194) |
| Interest in respect of the OCS (see also Note 8a) | - | (518) | (339) |
| Foreign currency translation differences | - | - | (850) |
| Other | - | (31) | (224) |
| | <u>(71)</u> | <u>(762)</u> | <u>(1,607)</u> |
| | <u>\$ 1,284</u> | <u>\$ 1,182</u> | <u>\$ 2,184</u> |

b. Net earnings (loss) per share:

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

| | Year ended December 31, | | |
|--|-------------------------|-----------|-----------|
| | 2006 | 2007 | 2008 |
| Numerator: | | | |
| Numerator for basic and diluted net earnings (loss) per share - income (loss) available to shareholders of Ordinary shares | \$ (5,460) | \$ 13,136 | \$ 25,977 |
| Denominator: | | | |
| Denominator for basic net earnings (loss) per | | | |

| | Year ended December 31, | | |
|---|-------------------------|-------------------|-------------------|
| | 2006 | 2007 | 2008 |
| share - weighted average number of shares | 26,728,053 | 29,692,670 | 36,863,684 |
| Effect of dilutive securities: | | | |
| Employee stock options | *) - | 2,408,723 | 1,474,900 |
| Denominator for diluted net earnings (loss) per share - adjusted weighted average number of shares | 26,728,053 | 32,101,393 | 38,338,584 |

*) Antidilutive.

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CERAGON NETWORKS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 13: RELATED PARTY BALANCES AND TRANSACTIONS

Most of the related party balances and transactions are with related companies and principal shareholders.

Yehuda Zisapel is a principal shareholder of the Company who, as of December 31, 2007 and 2008, owned 6.0% and 6.3% respectively of the Company's outstanding Ordinary shares. Zohar Zisapel is the Chairman of the Board of Directors and a principal shareholder of the Company who, as of December 31, 2007 and 2008, owned 8.4% and 11.5% respectively of the Company's outstanding Ordinary shares. Yehuda and Zohar Zisapel are brothers who do not have a voting agreement between them. Jointly or severally, they are also founders, directors and principal shareholders of several other companies that are known as the RAD-BYNET group.

Members of the RAD-BYNET group provide the Company on an as-needed basis with information systems, marketing, and administrative services, and the Company reimburses each company for its costs in providing these services. The aggregate amount of these expenses was approximately \$ 813, \$ 767 and \$ 1,170 in 2006, 2007 and 2008, respectively.

The Company leases its offices in Israel from real estate holding companies controlled by Yehuda and Zohar Zisapel. In June 2008, the Company extended its facility lease agreement until December 31, 2010. Additionally, the Company leases the U.S. subsidiary's office space from a real estate holding company controlled by Yehuda and Zohar Zisapel. The lease for this facility is valid until July 2013. The aggregate amount of rent and maintenance expenses related to these properties was approximately \$ 758 in 2006, \$ 778 in 2007 and \$ 1,403 in 2008.

The Company purchases certain inventory components from members of the RAD-BYNET group, which are integrated into its products. The aggregate purchase price of these components was approximately \$ 3,009, \$ 3,389 and \$ 4,338 for the years ended December 31, 2006, 2007 and 2008, respectively.

Transactions with related parties:

| | Year ended December 31, | | |
|--|-------------------------|------|------|
| | 2006 | 2007 | 2008 |
| | | | |

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| | <u>Year ended December 31,</u> | | |
|-------------------------------------|--------------------------------|----------|----------|
| Cost of revenues | \$ 3,472 | \$ 3,831 | \$ 4,836 |
| Research and development expenses | \$ 637 | \$ 579 | \$ 823 |
| Selling and marketing expenses | \$ 350 | \$ 418 | \$ 965 |
| General and administrative expenses | \$ 118 | \$ 105 | \$ 287 |

Balances with related parties:

| | <u>December 31,</u> | |
|---|---------------------|-------------|
| | <u>2007</u> | <u>2008</u> |
| Trade payables, other accounts payable and accrued expenses | \$ 115 | \$ 541 |