

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

FORM 20-F

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

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

For the fiscal year ended December 31, 2012

OR

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

OR

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

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

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

Commission file number 0-30070

AUDICODES LTD.

(Exact name of Registrant as specified in its charter  
and translation of Registrant's name into English)

ISRAEL

(Jurisdiction of incorporation or organization)

1 Hayarden Street, Airport City Lod 7019900, Israel

(Address of principal executive offices)

Shabtai Adlersberg, Chairman and CEO, Tel: 972-3-976-4105, Fax: 972-3-9764040, 1 Hayarden Street, Airport City, Lod 7019900 Israel

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

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value NIS 0.01 per share	NASDAQ Global Select Market

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

None  
\_\_\_\_\_  
(Title of Class)

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

None  
\_\_\_\_\_  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2012, the Registrant had outstanding 37,975,803 Ordinary Shares, nominal value NIS 0.01 per share.

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

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

Yes  No

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

Large Accelerated filer  Accelerated filer  Non-accelerated filer

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

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

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

---

## TABLE OF CONTENTS

	<b>Page</b>
ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS	1
ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE	1
ITEM 3. KEY INFORMATION	1
ITEM 4. INFORMATION ON THE COMPANY	25
ITEM 4A. UNRESOLVED STAFF COMMENTS	50
ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS	50
ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES	66
ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS	78
ITEM 8. FINANCIAL INFORMATION	79
ITEM 9. THE OFFER AND LISTING	80
ITEM 10. ADDITIONAL INFORMATION	82
ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	105
ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES	105
ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES	106
ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS	106
ITEM 15. CONTROLS AND PROCEDURES	106
ITEM 16. [RESERVED]	107
ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT	107
ITEM 16B. CODE OF ETHICS	107
ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES	107
ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	108
ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	108
ITEM 16F. CHANGE IN REGISTRANT'S CERTIFIED ACCOUNTANT	109
ITEM 16G. CORPORATE GOVERNANCE	109
ITEM 16H. MINE SAFETY DISCLOSURE	110
ITEM 17. FINANCIAL STATEMENTS	110
ITEM 18. FINANCIAL STATEMENTS	110
ITEM 19. EXHIBITS	110

## PRELIMINARY NOTE

This Annual Report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act, or the Exchange Act. These forward-looking statements can generally be identified as such because the context of the statement will include words such as may, “will,” “intends,” “plans,” “believes,” “anticipates,” “expects,” “estimates,” “predicts,” “potential,” “continue,” or “opportunity,” the negative of these words or words of similar import. Similarly, statements that describe our business outlook or future economic performance, anticipated revenues, expenses or other financial items, introductions and advancements in development of products, and plans and objectives related thereto, and statements concerning assumptions made or expectations as to any future events, conditions, performance or other matters, are also forward-looking statements. Forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those stated in such statements. Factors that could cause or contribute to such differences include, but are not limited to, those set forth under Item 3.D, “Key Information - Risk Factors” of this Annual Report.

Our actual results of operations and execution of our business strategy could differ materially from those expressed in, or implied by, the forward-looking statements. In addition, past financial and/or operating performance is not necessarily a reliable indicator of future performance and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. In evaluating our forward-looking statements, you should specifically consider the risks and uncertainties set forth under Item 3.D, “Key Information - Risk Factors” of this Annual Report.

## PART I

Unless the context otherwise requires, “AudioCodes,” “us,” “we” and “our” refer to AudioCodes Ltd. and its subsidiaries.

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. *SELECTED FINANCIAL DATA*

The selected financial data, set forth in the table below, have been derived from our audited historical financial statements for each of the years from 2008 through 2012. The selected consolidated statement of operations data for the years ended December 31, 2010, 2011 and 2012, and the selected consolidated balance sheet data as of December 31, 2011 and 2012, have been derived from our audited consolidated financial statements set forth elsewhere in this Annual Report. The selected consolidated statement of operations data for the years ended December 31, 2008 and 2009, and the selected consolidated balance sheet data as of December 31, 2008, 2009 and 2010, have been derived from our previously published audited consolidated financial statements, which are not included in this Annual Report. The selected financial data should be read in conjunction with our consolidated financial statements, and are qualified entirely by reference to these consolidated financial statements.

**Year Ended December 31,**

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>(In thousands, except per share data)</b>					
<b>Statement of Operations Data:</b>					
Revenues:					
Products	\$ 163,992	\$ 114,871	\$ 132,662	\$ 135,827	\$ 103,651
Services	10,752	11,023	17,378	20,025	23,839
<b>Total revenue</b>	<b>174,744</b>	<b>125,894</b>	<b>150,040</b>	<b>155,827</b>	<b>127,490</b>
Cost of revenues:					
Products	73,919	53,004	62,155	59,917	48,371
Services	3,536	3,190	3,983	4,228	5,923
<b>Total cost of revenue</b>	<b>77,455</b>	<b>56,194</b>	<b>66,138</b>	<b>64,145</b>	<b>54,294</b>
<b>Gross profit</b>	<b>97,289</b>	<b>69,700</b>	<b>83,902</b>	<b>91,682</b>	<b>73,196</b>
Operating expense:					
Research and development, net	37,833	29,952	30,189	32,150	28,677
Selling and marketing	44,657	32,111	35,024	43,248	40,040
General and administrative	9,219	7,821	8,252	9,028	8,214
Impairment of goodwill and intangible assets	85,015	-	-	-	-
<b>Total operating expenses</b>	<b>176,724</b>	<b>69,884</b>	<b>73,465</b>	<b>84,426</b>	<b>76,931</b>
<b>Operating income (loss)</b>	<b>(79,435)</b>	<b>(184)</b>	<b>10,437</b>	<b>7,256</b>	<b>(3,735)</b>
Financial expenses, net	3,268	2,744	94	423	453
<b>Income (loss) before taxes on income</b>	<b>(82,703)</b>	<b>(2,928)</b>	<b>10,343</b>	<b>7,679</b>	<b>(3,282)</b>
Income tax expense (benefit), net	505	290	(1,885)	(238)	(541)
Equity in losses of affiliated companies	2,582	76	213	277	(354)
<b>Net income (loss)</b>	<b>\$ (85,790)</b>	<b>\$ (3,294)</b>	<b>\$ 12,015</b>	<b>\$ 7,164</b>	<b>\$ (4,177)</b>
Net loss attributable to a non-controlling interest	-	\$ 472	\$ 111	\$ -	\$ -
<b>Net income (loss) attributable to AudioCodes' shareholders</b>	<b>\$ (85,790)</b>	<b>\$ (2,822)</b>	<b>\$ 12,126</b>	<b>\$ 7,164</b>	<b>\$ (4,177)</b>
<b>Basic net earnings (loss) per share</b>	<b>\$ (2.08)</b>	<b>\$ (0.07)</b>	<b>\$ 0.30</b>	<b>\$ 0.17</b>	<b>\$ (0.11)</b>
<b>Diluted net earnings (loss) per share</b>	<b>\$ (2.08)</b>	<b>\$ (0.07)</b>	<b>\$ 0.30</b>	<b>\$ 0.17</b>	<b>\$ (0.11)</b>
<b>Weighted average number of ordinary shares used in computing basic net earnings (loss) per share</b>	<b>41,201</b>	<b>40,208</b>	<b>40,560</b>	<b>41,438</b>	<b>39,125</b>
<b>Weighted average number of ordinary shares used in computing diluted net earnings (loss) per share</b>	<b>41,201</b>	<b>40,208</b>	<b>40,961</b>	<b>41,935</b>	<b>39,125</b>

	December 31,				
	2008	2009	2010	2011	2012
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 36,779	\$ 38,969	\$ 50,311	\$ 28,257	\$ 15,219
Short-term and restricted bank deposits, marketable securities and accrued interest	78,351	13,902	13,825	14,353	18,296
Working capital	57,370	54,557	66,537	55,083	46,598
Long-term and restricted bank deposits and long-term marketable securities	-	-	-	32,943	25,013
Total assets	230,304	147,533	173,718	192,677	166,004
Bank loans	27,750	21,750	15,750	33,155	22,913
Senior convertible notes	70,670	403	353	353	353
AudioCodes shareholders' equity	83,860	84,129	99,180	106,019	98,297
Non-controlling interest	228	(244)	-	-	-
Total equity	84,088	83,885	99,180	106,019	98,297
Capital stock (*)	167,981	170,062	172,263	176,998	178,623

(\*) Capital stock represents share capital plus additional paid-in capital, less carrying amount of the equity component of the senior convertible notes.

### Currency and Exchange Rates

The following table sets forth the exchange rates for one United States dollar ("US\$") expressed in terms of one New Israeli Shekel ("NIS") in effect at the end of the following years, (based on the exchange rate on the last day of each year).

	December 31,				
	2008	2009	2010	2011	2012
	3.802	3.775	3.549	3.821	3.733

The high and low exchange rates for each month during the previous six months are as follows (NIS per United States \$1.00):

Month	High	Low
October 2012	3.895	3.792
November 2012	3.952	3.810
December 2012	3.835	3.726
January 2013	3.791	3.714
February 2013	3.733	3.663
March 2013	3.733	3.637

The high, low, average (calculated by using the average of the exchange rates on the last day of each month during the period) and closing exchange rates for each of the Company's five previous fiscal years are as follows:

	<b>Year Ended December 31,</b>				
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
High	4.022	4.256	3.894	3.821	4.084
Low	3.230	3.690	3.549	3.363	3.700
Average	3.586	3.923	3.732	3.579	3.858
Period End	3.802	3.775	3.549	3.821	3.733

Unless otherwise indicated, in this Annual Report all references herein are to United States dollar.

The exchange rate on April 3, 2013, as reported by the Bank of Israel, for the conversion of United States dollars into New Israeli Shekel was U.S. \$1.00 equals NIS 3.618.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

**D. RISK FACTORS**

We are subject to various risks and uncertainties relating to or arising out of the nature of our business and general business, economic, financing, legal and other factors or conditions that may affect us. We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition, cash flows and results of operations.

***Risks Related to Our Business and Industry***

**We reported losses in 2008, 2009 and 2012. We may experience additional losses in the future.**

We reported a net loss of \$85.8 million in 2008, \$2.8 million in 2009 and \$4.2 million in 2012. We reported net income of \$12.1 million in 2010 and \$7.2 million in 2011. The loss in 2008 included a non-cash impairment charge of \$86.1 million taken in the fourth quarter of 2008 with respect to goodwill, intangible assets and investment in an affiliate. The majority of our expenses are directly and indirectly related to the number of people we employ. We may increase our expenses based on projections of revenue growth. If at any given time we do not meet our expectations for growth in revenues our expenses incurred in anticipation of projected revenues may cause us to incur a loss. We may not be able to anticipate a loss in advance and adjust our variable costs accordingly. We cannot be sure that we will be able to return to profitability in 2013.

**We have depended, and expect to continue to depend, on a small number of large customers. The loss of one or more of our large customers or the reduction in purchases by a significant customer or failure of such customer to pay for the products it purchases from us could have a material adverse effect on our revenues.**

Historically, a substantial portion of our revenues has been derived from large purchases by a small number of original equipment manufacturers, or OEMs, and network equipment providers, or NEPs, systems integrators and distributors. Our top three customers accounted for approximately 22.2% of our revenues in 2010, 25.5% of our revenue in 2011 and 25.3% of our revenues in 2012. Sales to ScanSource Communications Inc., our largest customer, accounted for 13.9% of our revenues in 2012 compared to 14.4% of our revenues in 2011 and 9.8% of our revenues in 2010. We do not enter into sales agreements in which a customer is obligated to purchase a set quantity of our products. Based on our experience, we expect that our customer base may change from period to period. If we lose a large customer and fail to add new customers, or if purchases made by such customers are significantly reduced, there could be a material adverse effect on our results of operations. For example, Nortel Networks was our largest customer in 2008 and 2009 accounting for 14.4% of our revenues in 2008 and 15.6% of our revenues in 2009. Nortel filed for bankruptcy protection in January 2009. In 2010, Nortel accounted for only 3.9% of our revenue, in 2011 revenues from sales to Nortel were negligible, and, in 2012, there were no revenues from sales to Nortel. Our sales to companies that purchased units of Nortel are significantly less than our sales to Nortel. The reduction in sales to Nortel and the purchasers of its business units negatively affected our results of operations. Any significant reduction in sales to other large customers similar to the loss of our sales to Nortel could have a material adverse effect on our results of operations.

**Recent and future economic conditions may adversely affect our business.**

The uncertain economic and credit environment is having a negative impact on business around the world. The impact of these conditions on the technology industry and our major customers and potential customers has been significant. Conditions may continue to be uncertain or may be subject to deterioration which could lead to a further reduction in consumer and customer spending overall, which could have an adverse impact on sales of our products. A disruption in the ability of our significant customers to access liquidity could cause serious disruptions or an overall deterioration of their businesses which could lead to a significant reduction in their orders of our products and the inability or failure on their part to meet their payment obligations to us, any of which could have a material adverse effect on our results of operations and liquidity. A significant adverse change in a customer's financial and/or credit position could also require us to assume greater credit risk relating to that customer's receivables or could limit our ability to collect receivables related to previous purchases by that customer. As a result, our reserves for doubtful accounts and write-offs of accounts receivable could increase.

**We may need additional financing to operate or grow our business. We may not be able to raise additional financing for our capital needs on favorable terms, or at all, which could limit our ability to grow and to continue our longer term expansion plans.**

We may need additional financing to operate our business or continue our longer term expansion plans. To the extent that we cannot fund our activities and acquisitions through our existing cash resources and any cash we generate from operations, we may need to raise equity or debt funds through additional public or private financings. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms, or at all. This could inhibit our growth, increase our financing costs or cause us severe financial difficulties.

**We have a significant amount of bank debt and could be forced to repay this debt in advance if we are unable to satisfy the covenants in our loan agreements.**

We borrowed \$30 million in 2008 that is repayable in 20 equal quarterly payments of \$1.5 million from August 2008 through July 2013. In 2011, we borrowed an additional \$23.8 million. Of that amount, \$19.9 million is repayable in 20 equal quarterly payments of approximately \$1.0 million from December 2011 through September 2017 and the remaining \$3.9 million is repayable in 10 equal semiannual payments of \$390,000 from June 2012 through December 2016. If we are unable to make payments when required by these loan agreements or if we do not comply with covenants in our loan agreements with respect to maintaining shareholders' equity at specified levels or achieving certain levels of operating income, we could be required to repay all or portion of these bank loans prior to their maturity. During 2011 and 2012, we were not in compliance with some of the financial covenants contained in our loan agreements. Each of our lenders agreed to waive compliance with these covenants subject to compliance with revised financial covenants during the remainder of 2012 and 2013. If we are unable to comply with these revised financial covenants in the future, our lenders could require us to repay all of our outstanding loans.



**We are party to an agreement for the construction and long-term lease of a new building in Israel. We are currently engaged in a dispute with the landlord with respect to this lease. Any unfavorable outcome in this dispute could result in significant damages to us.**

In May 2007, we entered into an agreement with respect to property adjacent to our headquarters in Israel, pursuant to which a building of approximately 145,000 square feet has been erected and was expected to be leased to us for a period of eleven years. This new building was substantially completed on a structural level in May 2010. The landlord claimed that we should have taken delivery of the building at that time and started paying rent. We disagreed with the landlord's interpretation of the relevant agreement. As a result, the landlord terminated the agreement and leased the property to a third party. This dispute has been referred to arbitration where we claim that due to the landlord's failure we lost significant potential revenues. The landlord counterclaimed alleging that it sustained losses equal to approximately one year's rent and management fees in the aggregate amount of approximately NIS 14 million (approximately \$3.75 million based on the December 31, 2012 exchange rate). It is not possible at this stage to predict the outcome of these proceedings. We believe that we have valid defenses to the counterclaim. An unfavorable outcome in the arbitration could result in the payment by us of a significant amount to the landlord.

**We are dependent on the development of the VoIP market to increase our sales.**

We are dependent on the development of the Voice over Internet Protocol, or VoIP, market to increase our sales. We cannot be sure that the delivery of telephone and other communications services over packet networks will continue to expand or that there will be a need to interconnect to other networks utilizing the type of technology contained in our products. For example, the need for our media gateway products depends on the need to interconnect VoIP networks with traditional non-packet based networks. Our enterprise session border control products depend on growth in the need to interconnect Voice over Packet and unified communication systems with each other. The adaptation process of connecting packet networks and telephone networks can be time consuming and costly. Sales of our VoIP products will depend on the continued development of packet networks and the commercialization of VoIP services. If this market develops more slowly than we expect, we may not be able to sell our products in a significant enough volume to be profitable.

**We may expand our business through acquisitions that could result in diversion of resources and extra expenses. This could disrupt our business and affect our results of operations.**

Part of our strategy is to pursue acquisitions of, or investments in, businesses and technologies or to establish joint ventures to expand our business. The negotiation of acquisitions, investments or joint ventures, as well as the integration of acquired or jointly developed businesses or technologies, could divert our management's time and resources. Acquired businesses, technologies or joint ventures may not be successfully integrated with our products and operations. The markets for the products produced by the companies we acquire may take longer than we anticipated to develop and to result in increased sales and profits for us. We may not realize the intended benefits of any acquisition, investment or joint venture and we may incur losses from any acquisition, investment or joint venture.

The future valuation of acquired businesses may be less than the purchase price we paid and result in impairment charges related to goodwill or intangible assets. During the fourth quarter of 2008, we recognized non-cash impairment charges of \$86.1 million with respect to goodwill and intangible assets related to previous acquisitions and an investment in an affiliated company.

In addition, acquisitions could result in:

- substantial cash expenditures;
- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- a decrease in our profit margins;
- amortization of intangibles and potential impairment of goodwill and intangible assets, such as occurred during 2008;
- reduction of management attention to other parts of the business;
- failure to invest in different areas or alternative investments;
- failure to generate expected financial results or reach business goals; and
- increased expenditures on human resources and related costs.

If acquisitions disrupt our sales or marketing efforts or operations, our business may suffer.

**If new products we recently introduced or expect to introduce in the future fail to generate the level of demand we anticipated, we will realize a lower than expected return from our investment in research and development with respect to those products, and our results of operations may suffer.**

Our success is dependent, in part, on the willingness of our customers to transition or migrate to new products, such as our expanded offering of Mediant and IP media products, our residential gateways, our session border controller products, our multi service business gateways (MSBRs), our software application products or expected future products. We are involved in a continuous process of evaluating changing market demands and customer requirements in order to develop and introduce new products, features and applications to meet changing demands and requirements. We need to be able to interpret market trends and the advancement of technology in order to successfully develop and introduce new products, features and applications. If potential customers defer transition or migration to new products, our return on our investment in research and development with respect to products recently introduced or expected to be introduced in the near future will be lower than we originally anticipated and our results of our operations may suffer.

**Because of the rapid technological development in the communications equipment market and the intense competition we face, our products can become outmoded or obsolete in a relatively short period of time, which requires us to provide frequent updates and/or replacements to existing products. If we do not successfully manage the transition process to the next generation of our products, our operating results may be harmed.**

The communications equipment market is characterized by rapid technological innovation and intense competition. Accordingly, our success depends in part on our ability to develop next generation products in a timely and cost-effective manner. The development of new products is expensive, complex and time consuming. If we do not rapidly develop our next generation products ahead of our competitors, we may lose both existing and potential customers to our competitors. Further, if a competitor develops a new, less expensive product using a different technological approach to delivering informational services over existing networks, our products would no longer be competitive. Conversely, even if we are successful in rapidly developing new products ahead of our competitors and we do not cost-effectively manage our inventory levels of existing products when making the transition to the new products, our financial results could be negatively affected by high levels of obsolete inventory. If any of the foregoing were to occur, then our operating results would be harmed.

**Our industry is rapidly evolving and we may not be able to keep pace with technological changes, which could adversely affect our business.**

The transmission of multimedia over data networks is rapidly evolving. Short product life cycles place a premium on our ability to manage the transition from current products to new products. Our future success in generating revenues will depend on our ability to enhance our existing products and to develop and introduce new products and product features. These products and features must keep pace with technological developments and address the increasingly sophisticated needs of our customers. The development of new technologies and products is increasingly complex and uncertain. This increases the difficulty in coordinating the planning and production process and can result in delay in the introduction of new technologies and products.

**The increase in the number of IP networks may adversely affect the demand for media gateway products.**

Media gateway products are primarily intended to transcode voice from traditional telephony networks to IP networks and vice versa. Along with the growth in the number of IP networks, there has been an increase in the amount of information that is sent directly from one IP network to another IP network. This direct network communication potentially obviates the need to use a media gateway or transcoding. A reduction in the demand for media gateways may adversely affect the demand for our media gateway products and, in turn, adversely affect our results of operations.

**New industry standards, the modification of our products to meet additional existing standards or the addition of features to our products may delay the introduction of our products or increase our costs.**

The industry standards that apply to our products are continually evolving. In addition, since our products are integrated into networks consisting of elements manufactured by various companies, they must comply with a number of industry standards and practices established by various international bodies and industry forums. Should new standards gain broad acceptance, we will be required to adopt those standards in our products. We may also decide to modify our products to meet additional existing standards or add features to our products. Standards may be adopted by various industry interest groups or may be proprietary and nonetheless accepted broadly in the industry. It may take us a significant amount of time to develop and design products incorporating these new standards. We may also have to pay additional fees to the developers of the technologies which constitute the newly adopted standards.

**Our OEM customers or potential customers may develop or prefer to develop their own technical solutions, or purchase third party technology, and as a result, would not buy our products.**

Our products are sold also as components or building blocks to large OEMs and NEPs. These customers incorporate our products into their product offerings, usually in conjunction with value-added services of their own or of third parties. OEM or NEP customers or potential customers may prefer to develop their own technology or purchase third party technology. They could also manufacture their own components or building blocks that are similar to the ones we offer. Large customers have already committed significant resources in developing integrated product offerings. Customers may decide that this gives them better profitability and/or greater control over supplies, specifications and performance. Customers may therefore not buy components or products from an external manufacturer such as us. This could have an adverse impact on our ability to sell our products and our revenues.

**We have a limited order backlog. If revenue levels for any quarter fall below our expectations, our results of operations will be adversely affected.**

We have a limited order backlog, which makes revenues in any quarter substantially dependent on orders received and delivered in that quarter. A delay in the recognition of revenue, even from one customer, may have a significant negative impact on our results of operations for a given period. We base our decisions regarding our operating expenses on anticipated revenue trends, and our expense levels are relatively fixed, or require some time for adjustment. Because only a small portion of our expenses varies with our revenues, if revenue levels fall below our expectations, our results of operations will be adversely affected.

**Generally, we sell to original equipment manufacturers, or OEMs, network equipment providers or system integrator customers, as well as to distributors. As a result, we have less information with respect to the actual requirements of end-users and their utilization of equipment. We also have less influence over the choice of equipment by these end-users.**

We typically sell to OEM customers, network equipment providers, and system integrators, as well as to distributors. Our customers usually purchase equipment from several suppliers and may be trying to fulfill one of their customers' specific technical specifications. We rely heavily on our customers for sales of our products and to inform us about market trends and the needs of their customers. We cannot be certain that this information is accurate. If the information we receive is not accurate, we may be manufacturing products that do not have a customer or fail to manufacture products that end-users want. Because we are selling products to OEMs, system integrators and distributors rather than directly to end-users, we have less control over the ultimate selection of products by end-users.

**We have invested significant resources in developing products compatible with Microsoft Lync related solutions. If Microsoft abandons this solution, decides to promote products of our competitors instead of our products, is unwilling to continue to recognize AudioCodes as its partner or fails to achieve the expected growth of Lync, our results of operations will be adversely affected.**

We have invested significant resources in complying with Microsoft's requirements for the purpose of becoming a Microsoft recognized partner for their unified communication solutions for the enterprise market, which are known as Microsoft Lync. We believe that recognition as a Microsoft partner enhances our access to and visibility in markets relevant to our products. We are dependent on the users of Microsoft Lync to recognize the utility of our compatible products and purchase them. If Microsoft were to abandon Lync, decide to promote the products of our competitors instead of our products, is unwilling to continue to recognize AudioCodes as a Lync partner or fails to achieve the expected growth of Lync, our results of operations will be adversely affected.

**The markets we serve are highly competitive and many of our competitors have much greater resources, which may make it difficult for us to maintain profitability.**

Competition in our industry is intense and we expect competition to increase in the future. Our competitors currently sell products that provide similar benefits to those that we sell. There has been a significant amount of merger and acquisition activity and strategic alliances, frequently involving major telecommunications equipment manufacturers acquiring smaller companies, and we expect that this will result in an increasing concentration of market share among these companies, many of whom are our customers.

Our principal competitors in the area of analog media gateways (2 to 24 ports) for access and enterprise are Linksys (a division of Cisco Systems, Inc.), Mediatrix Telecom, Inc., Vega Stream Limited, Innovaphone AG, NET (acquired by Sonus Networks), Tainet Communication System Corp., D-Link Systems, Inc., Patton, Sangoma, Dialogic and Edgewater.

Our principal competitors in the residential gateway market are Pirelli Broadband (ADB), Technicolor (previously Thomson), Sagemcom, ZyXEL, Netgear, Bewan (Pace), Huawei, FiberHome and ZTE.

In the area of low and mid density digital gateways we face competition from companies such as Nokia-Siemens, Huawei, and from Cisco, Dialogic, Genband, Sonus Networks, NET (acquired by Sonus Networks), Patton, Ferrari and Snagoma.

Our competitors in the area of multi service business gateways are companies such as Cisco, Juniper, Adtran, One-Access, Patton, Huawei, HP/3COM, Alcatel and more.

Specifically in the area of enterprise class session border controller technology we compete with ACME Packet (acquired by Oracle), Cisco, SIPera (acquired by Avaya), Sonus Networks, NET (acquired by Sonus Networks), Ingate and Edgewater.

Our competitors in the Microsoft Lync certified gateways and session border controller markets include NET (acquired by Sonus Networks), Dialogic, Cisco, Ferrari and ACME Packet (acquired by Oracle).

Some of our competitors are also customers of our products and technologies.

Our principal competitors in the sale of signal processing chips are Broadcom, Octasic and Mindspeed. Other indirect competition is arriving from the integration of VoIP functionality into processors (running VoIP signal processing on generic ARM/MIPS cores), thus decreasing the need for dedicated signal processing chips in the VoIP product. Examples to such manufacturers are Cavium, Texas Instruments and more. Our principal competitors in the communications board market are Dialogic, Sangoma and PIKA Technologies.

Our principal competitors in the area of IP Phones are comprised of “best-of-breed” IP phone vendors and end-to-end IP telephony vendors. “Best of breed” IP phone vendors sell standard-based SIP phones that can be integrated into any standards-based IP-PBX or hosted IP telephony system. These competitors include Polycom, HP, Yalink and SNOM. End-to-end IP telephony vendors sell IP phones that only work in their proprietary systems. These competitors include Cisco, Avaya, Alcatel-Lucent, Siemens, Aastra, NEC and more.

Many of our competitors have the ability to offer complete network solutions and vendor-sponsored financing programs to prospective customers. Some of our competitors with broad product portfolios may also be able to offer lower prices on products that compete with ours because of their ability to recoup a loss of margin through sales of other products or services. Additionally, voice, audio and other communications alternatives that compete with our products are being continually introduced.

In the future, we may also develop and introduce other products with new or additional telecommunications capabilities or services. As a result, we may compete directly with VoIP companies and other telecommunications and solution infrastructure providers, some of which may be our customers. Additional competitors may include companies that currently provide communication software products and services. The ability of some of our competitors to bundle other enhanced services or complete solutions with VoIP products could give these competitors an advantage over us.

**Offering to sell system level products that compete with the products manufactured by our customers could negatively affect our business.**

Our product offerings range from media gateway building blocks, such as chips and boards, to media gateways, media servers and session border control products (systems). These products could compete with products offered by our customers. These customers could decide to decrease purchases from us because of this competition. This could result in a material adverse effect on our results of operations.

**Offering to sell directly to carriers or service providers may expose us to requirements for service which we may not be able to meet.**

We also sell our products directly to telecommunications carriers, service providers or other end-users. We have traditionally relied on third party distributors and OEMs to test and/or sell our products and to inform us about the requirements of end-users. We have limited experience selling our products directly to end-user customers. Telecommunications carriers and other service providers have great bargaining power in negotiating contracts. Generally, contracts with end-users tend to be more complex and impose more obligations on us than contracts with third party distributors. We may be unable to meet the requirements of these contracts. If we are unable to meet the conditions of a contract with an end-user customer, we may be subject to liquidated damages or liabilities that could result in a material adverse effect on our results of operations.

Selling directly to end-users may adversely affect our relationship with our current third party distributors upon whom we will continue to rely for a significant portion of our sales. Loss of third party distributors and OEMs, or a decreased commitment by them to sell our products as a result of direct sales by us, could adversely affect our sales and results of operations.

**We rely on third-party subcontractors to assemble our products and therefore do not directly control manufacturing costs, product delivery schedules or manufacturing quality.**

Our products are assembled and tested by third-party subcontractors. As a result of our reliance on third-party subcontractors, we cannot directly control product delivery schedules. We have in the past experienced delays in delivery schedules. Any problems that occur and persist in connection with the delivery, quality or cost of the assembly and testing of our products could have a material adverse effect on our business, financial condition and results of operations. This reliance could also lead to product shortages or quality assurance problems, which, in turn, could lead to an increase in the costs of manufacturing or assembling our products.

In addition, we have engaged several original design manufacturers, or ODMs, based in Asia to design and manufacture some of our products and may engage additional ODMs in the future. Any problems that occur and persist in connection with the delivery, quality, cost of the assembly or testing of our products, as well as the termination of our commercial relationship with an ODM or the discontinuance of the manufacturing of the respective products could have a material adverse effect on our business, financial condition and results of operations.

**We may not be able to deliver our products to our customers, and substantial reengineering costs may be incurred if a small number of third-party suppliers do not provide us with key components on a timely basis.**

Texas Instruments Incorporated supplies all of the chips for our signal processor product line. Our signal processor line is used both as a product line in its own right and as a key component in our other product lines. Motorola and Cavium Networks manufacture all of the communications and network processors currently used on our embedded communications boards and network products.

We have not entered into any long-term supply agreements or alternate source agreements with our suppliers and, while we maintain an inventory of critical components, our inventory of chips would likely not be sufficient in the event that we had to engage an alternate supplier for these components.

An unexpected termination of the supply of the chips provided by Texas Instruments or the communications processors supplied by Motorola or Cavium Networks or disruption in their timely delivery would require us to make a large investment in capital and personnel to shift to using chips or signal processors manufactured by other companies and may cause a delay in introducing replacement products. Customers may not accept an alternative product design. Supporting old products or redesigning products may make it more difficult for us to support our products.

**We utilize other sole source suppliers upon whom we depend without having long-term supply agreements.**

Some of our sole source suppliers custom produce components for us based upon our specifications and designs while other of our sole source suppliers are the only manufacturers of certain components required by our products. We have not entered into any long-term supply agreements or alternative source agreements with our suppliers and while we maintain an inventory of components from single source providers, our inventory would likely not be sufficient in the event that we had to engage an alternate supplier of these single source components. In the event of any interruption in the supply of components from any of our sole source suppliers, we may have to expend significant time, effort and other resources in order to locate a suitable alternative manufacturer and secure replacement components. If no replacement components are available, we may be forced to redesign certain of our products. Any such new design may not be accepted by our customers. A prolonged disruption in supply may force us to redesign and retest our products. Any interruption in supply from any of these sources or an unexpected technical failure or termination of the manufacture of components could disrupt production, thereby adversely affecting our ability to deliver products and to support products previously sold to our customers.

In addition, if demand for telecommunications equipment increases, we may face a shortage of components from our suppliers. This could result in longer lead times, increases in the price of components and a reduction in our margins, all of which could adversely affect the results of our operations.

**Our customers may require us to produce products or systems to hold in inventory in order to meet their “just in time,” or short lead time, delivery requirements. If we are unable to sell this inventory on a timely basis, we could incur charges for excess and obsolete inventory which would adversely affect our results of operations.**

Our customers expect us to maintain an inventory of products available for purchase off the shelf subsequent to the initial sales cycle for these products. This may require us to incur the costs of manufacturing inventory without having a purchase order for the products. The VoIP industry is subject to rapid technological change and volatile customer demands, which result in a short product commercial life before a product becomes obsolete. If we are unable to sell products that are produced to hold in inventory, we may incur write-offs as a result of slow moving items, technological obsolescence, excess inventories, discontinued products and products with market prices lower than cost. Write-offs could adversely affect our operating results and financial condition. We wrote off inventory in an aggregate amount of \$1.1 million in 2010, \$644,000 in 2011 and \$2.3 million in 2012.

**The right of our customers to return products and their right to exchange products may affect our ability to recognize revenues which could adversely affect the results of our operations.**

Some of our customers expect us to permit them to return some or all of the products they purchase from us. If we contractually agree to allow a customer to return products, the customer may be entitled to a refund for the returned products or to receive a credit for the purchase of replacement products. If we agree to this type of contractual obligation, it could affect our ability to recognize revenues. In addition, if we are not able to resell any products that are returned, we would have to write off this inventory. This could adversely affect our results of operations.

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

Our products are technologically complex and are typically intended for use in applications that may be critical to the business of our customers. Prospective customers generally must make a significant commitment of resources to test and evaluate our products and to integrate them into larger systems. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. The sales cycles of our products to new customers are approximately six to twelve months after a design win, depending on the type of customer and complexity of the product. This time period may be further extended because of internal testing, field trials and requests for the addition or customization of features. This delays the time until we realize revenue and results in significant investment of resources in attempting to make sales.

Long sales cycles also subject us to risks not usually encountered in a short sales span, including customers' budgetary constraints, internal acceptance reviews and cancellation. In addition, orders expected in one quarter could shift to another because of the timing of customers' procurement decisions. The time required to implement our products can vary significantly with the needs of our customers and generally exceeds several months; larger implementations can take multiple calendar quarters. This complicates our planning processes and reduces the predictability of our revenues.

**Our proprietary technology is difficult to protect, and our products may infringe on the intellectual property rights of third parties. Our business may suffer if we are unable to protect our intellectual property or if we are sued for infringing the intellectual property rights of third parties.**

Our success and ability to compete depend in part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement, or to protect us from the claims of others.

Enforcement of intellectual property rights may be expensive and may divert attention of management and of research and development personnel away from our business. Intellectual property litigation could also call into question the ownership or scope of rights owned by us. We believe that at least one of our patents may cover technology related to the ITU G.723.1 standard. Because of our involvement in the standard setting process, we may be required to license certain of our patents on a reasonable and non-discriminatory basis to a current or future competitor, to the extent required to carry out the G.723.1 standard. Additionally, our products may be manufactured, sold, or used in countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws or where we do not hold relevant intellectual property rights.

We believe that the frequency of third-party intellectual claims is increasing, as patent holders, including entities that are not in our industry and that purchase patents as an investment or to monetize such rights by obtaining royalties, use infringement assertions as a competitive tactic and a source of additional revenue. Any intellectual property claims against us, even without merit, could cost us a significant amount of money to defend and divert management's attention away from our business. We may not be able to secure a license for technology that is used in our products and we may face injunctive proceedings that prevent distribution and sale of our products even prior to any dispute being concluded. These proceedings may also have a deterrent effect on purchases by customers, who may be unsure about our ability to continue to supply their requirements. We may be forced to repurchase our products and compensate customers that have purchased such infringing products. We may be forced to redesign the product so that it becomes non-infringing, which may have an adverse impact on the results of our operations.



In addition, claims alleging that the development, use, or sale of our products infringes third parties' intellectual property rights may be directed either at us or at our direct or indirect customers. We may be required to indemnify such customers against claims made against them. We may be required to indemnify them even if we believe that the claim of infringement is without merit.

**Multiple patent holders in our industry may result in increased licensing costs.**

There are a number of companies besides us that hold patents for various aspects of the technology incorporated in our industry's standards and our products. We expect that patent enforcement will be given high priority by companies seeking to gain competitive advantages or additional revenues. We have been sued a number of times in recent years for alleged patent infringement. The holders of patents from which we have not obtained licenses may take the position that we are required to obtain a license from them. We cannot be certain that we would be able to negotiate a license agreement at an acceptable price or at all. Our results of operations could be adversely affected by the payment of any additional licensing costs or if we are prevented from manufacturing or selling a product.

**Changes in governmental regulations in the United States or other countries could slow the growth of the VoIP telephony market and reduce the demand for our customers' products, which, in turn, could reduce the demand for our products.**

VoIP and other services are not currently subject to all of the same regulations that apply to traditional telephony. Nevertheless, it is possible that foreign or U.S. federal or state legislatures may seek to impose increased fees and administrative burdens on VoIP, data, and video providers. The FCC has already required VoIP service providers to meet various emergency service requirements relating to delivery of 911 calls, known as E911, and to accommodate law enforcement interception or wiretapping requirements, such as the Communications Assistance for Law Enforcement Act, or CALEA. In addition, the FCC may seek to impose other traditional telephony requirements such as disability access requirements, consumer protection requirements, number assignment and portability requirements, and other obligations, including additional obligations regarding E911 and CALEA.

The cost of complying with FCC regulations could increase the cost of providing Internet phone service which could result in slower growth and decreased profitability for this industry, which would adversely affect our business.

The enactment of any additional regulation or taxation of communications over the Internet in the United States or elsewhere in the world could have a material adverse effect on our customers' (and their customers') businesses and could therefore adversely affect sales of our products. We do not know what effect, if any, possible legislation or regulatory actions in the United States or elsewhere in the world may have on private telecommunication networks, the provision of VoIP services and purchases of our products.

**Use of encryption technology in our products is regulated by governmental authorities and may require special development, export or import licenses. Delays in the issuance of required licenses, or the inability to secure these licenses, could adversely affect our revenues and results of operations.**

Growth in the demand for security features may increase the use of encryption technology in our products. The use of encryption technology is generally regulated by governmental authorities and may require specific development, export or import licenses. Encryption standards may be based on proprietary technologies. We may be unable to incorporate encryption standards into our products in a manner that will insure interoperability. We also may be unable to secure licenses for proprietary technology on reasonable terms. If we cannot meet encryption standards, or secure required licenses for proprietary encryption technology, our revenues and results of operations could be adversely affected.

**We are subject to regulations that require us to use components based on environmentally friendly materials. We may be subject to various regulations relating to management and disposal of waste with respect to electronic equipment. Compliance with these regulations has increased our costs. Failure to comply with these regulations could materially adversely affect our results of operations.**

We are subject to an increasing number of telecommunications industry regulations requiring the use of environmentally-friendly materials in telecommunications equipment. For example, pursuant to a European Community directive, telecom equipment suppliers are required to stop using specified materials that are not environmentally friendly. In addition, telecom equipment suppliers that take advantage of an exemption with respect to the use of lead in solders are required by this directive to eliminate the lead in solders from their products by the time set forth by the European Community regulations. This exemption has been extended by the authorities. Some of our customers may also require products that meet higher standards than those required by the directive, such as complete removal of additional harmful substances from our products. We are dependent on our suppliers for components and sub-system modules, such as semiconductors and purchased assemblies and goods, to comply with these requirements. This may harm our ability to sell our products in regions or to customers that may adopt such directives.

Compliance with these directives, especially with respect to the requirement that products eliminate lead solders, has required us to undertake significant expenses with respect to the re-design of our products. In addition, we may be required to pay higher prices for components that comply with this directive. We may not be able to pass these higher component costs on to our customers. Compliance with these regulations have increased and could continue to increase our product design costs. New designs may also require qualification testing with both customers and government certification boards. We cannot be certain of the reliability of any new designs that utilize non-lead components. While we have not experienced any significant reliability issues as a result of using non-lead components, the incorporation of these new components could adversely affect equipment reliability and durability.

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment, including laws governing the management and disposal of waste with respect to electronic equipment. We could incur substantial costs, including fines and civil or criminal sanctions, if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws. We also face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the materials that compose our products. The EU has enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. Similar legislation has been or may be enacted in other jurisdictions, including the United States, Canada, Mexico, China and Japan.

Our inability or failure to comply with these regulations could have a material adverse effect on our results of operations. In addition, manufacturers of components that use lead solders may decide to stop manufacturing those components prior to the required compliance date. These actions by manufacturers of components could result in a shortage of components that could adversely affect our business and results of operations.

**A significant portion of our revenues is generated outside of the United States and Israel. We intend to continue to expand our operations internationally and, as a result, our results of operations could suffer if we are unable to manage our international operations effectively.**

We generated approximately 39% of our revenues in 2010, 37% of our revenues in 2011 and 42% of our revenues in 2012, outside of the United States and Israel. Part of our strategy is to expand our penetration in existing foreign markets and to enter new foreign markets. Our ability to penetrate some international markets may be limited due to different technical standards, protocols or product requirements in different markets. Expansion of our international business will require significant management attention and financial resources. Our international sales and operations are subject to numerous risks inherent in international business activities, including:

- economic and political instability in foreign countries;
- compliance with foreign laws and regulations;
- different technical standards or product requirements;
- staffing and managing foreign operations;
- foreign currency fluctuations;
- export control issues;
- governmental controls;
- import or currency control restrictions;
- local taxation;
- increased risk of collection; and
- burdens that may be imposed by tariffs and other trade barriers.

If we are unable to address these risks, our foreign operations may be unprofitable or the value of our investment in our foreign operations may decrease.

**The prices of our products may become less competitive due to foreign exchange fluctuations.**

Although we have operations throughout the world, the majority of our revenues and our operating costs in 2012 were denominated in, or linked to, the U.S. dollar. Accordingly, we consider the U.S. dollar to be our functional currency. However, a significant portion of our operating costs in 2012 were incurred in New Israeli Shekels (NIS). During 2012, the NIS appreciated against the U.S. dollar, which resulted in an increase in the U.S. dollar cost of our operations in Israel. As a result of this differential, from time to time we may experience increases in the costs of our operations outside the United States, as expressed in U.S. dollars. If there is a significant increase in our expenses, we may be required to increase the prices of our products and may be less competitive. Currently, our international sales are denominated primarily in U.S. dollars. Therefore, any devaluation in the local currencies of our customers relative to the U.S. dollar could cause customers to decrease or cancel orders or default on payment.

Our sales to European customers denominated in Euros are increasing. Sales denominated in Euros could make our revenues subject to fluctuation in the Euro/U.S. dollar exchange rate. If the U.S. dollar appreciates against the Euro, we may be required to increase the prices of our products that are denominated in Euros. In 2012, the U.S. dollar depreciated against the Euro, which resulted in a decrease in the prices of our products that are denominated in Euros. If the U.S. dollar appreciates against the Euro, we may be required to increase the prices of our products that are denominated in Euros.

**We may be unable to attract sales representatives who will market our products effectively.**

A significant portion of our marketing and sales involves the aid of independent sales representatives that are not under our direct control. We cannot be certain that our current independent sales representatives will continue to distribute our products or that, even if they continue to distribute our products, they will do so successfully. These representatives are not subject to any minimum purchase requirements and can discontinue marketing our products at any time. In addition, these representatives often market products of our competitors. Accordingly, we must compete for the attention and sales efforts of our independent sales representatives.

**Our products could contain defects, which would reduce sales of those products or result in claims against us.**

We develop complex and evolving products. Despite testing by us and our customers, undetected errors or defects may be found in existing or new products. The introduction of products with reliability, quality or compatibility problems could result in reduced revenues, additional costs, increased product returns and difficulty or delays in collecting accounts receivable. The risk is higher with products still in the development stage, where full testing or certification is not yet completed. This could result in, among other things, a delay in recognition or loss of revenues, loss of market share or failure to achieve market acceptance. We could also be subject to material claims by customers that are not covered by our insurance.

**Obtaining certification of our products by national regulators may be time-consuming and expensive. We may be unable to sell our products in markets in which we are unable to obtain certification.**

Our customers may expect us to obtain certificates of compliance with safety and technical standards set by national regulators, especially standards set by U.S. or European regulators. There is no uniform set of standards, and each national regulator may impose and change its own standards. National regulators may also prohibit us from importing products that do not conform to their standards. If we make any change in the design of a product, we are usually required to obtain recertification of the product. The process of certification may be time-consuming and expensive and may affect the length of the sales cycle for a product. If we are unable to obtain certification of a product in a market, we may be unable to sell the product in that market.

**We depend on a limited number of key personnel who would be difficult to replace.**

Because our products are complex and our market is evolving, the success of our business depends in large part upon the continuing contributions of our management and key personnel. Specifically, we rely heavily on the services of Shabtai Adlersberg, our Chief Executive Officer and President, and Lior Aldema, our Chief Operating Officer and Head of Global Sales. If our Chief Executive Officer, Chief Operating Officer and Head of Global Sales are unable or unwilling to continue with us, our results of operations could be materially and adversely affected. We do not carry key person insurance for our key personnel.

The success of our business also depends upon our continuing ability to attract and retain other highly-qualified management, technical, sales and marketing personnel. We need highly-qualified technical personnel who are capable of developing technologies and products and providing the technical support required by our customers. We experience competitive pressure with respect to retaining and hiring employees in the high technology sector in Israel. If we fail to hire and retain skilled employees, our business may be adversely affected.

**If we do not manage our operations effectively, our results of operations could be adversely affected.**

We have actively expanded our operations in the past and may continue to expand them in the future. This expansion has required, and may continue to require, the application of managerial, operational and financial resources. We cannot be sure that we will continue to expand, or that we will be able to expand our operations successfully. In particular, our business requires us to focus on multiple markets, including the VoIP, wireline, cable, enterprise unified communications and wireless markets. In addition, we work simultaneously with a number of large OEMs and network equipment providers each of which may have different requirements for the products that we sell to them. We may not have sufficient personnel, or may be unable to devote this personnel when needed, to address the requirements of these markets and customers. If we are unable to manage our operations effectively, our revenues may not increase, our cost of operations may rise and our results of operations may be adversely affected.

As we grow we may need new or enhanced systems, procedures or controls. The transition to such systems, procedures or controls, as well as any delay in transitioning to new or enhanced systems, procedures or controls, may seriously harm our ability to accurately forecast sales demand, manage our product inventory and record and report financial and management information on a timely and accurate basis.

**Our gross profit percentage could be negatively impacted by amortization expenses in connection with acquisitions, increased manufacturing costs and other factors. This could adversely affect our results of operations.**

Our gross profit percentage decreased in 2008, 2009 and 2012 and increased in 2010 and 2011. The decrease in our gross profit percentage in 2008 was primarily attributable to amortization expenses related to the acquisitions of Nuera and Netrake beginning in the third quarter of 2006 and CTI Squared beginning in the second quarter of 2007, as well as expenses related to equity-based compensation resulting from the adoption of Accounting Standards Codification, or ASC, 718 beginning in 2006. During the fourth quarter of 2008, we recognized non-cash impairment charges of \$86.1 million with respect to goodwill, intangible assets and investment in an affiliate. As a result of these impairment charges, non-cash amortization expense included in cost of revenues declined in 2009, 2010, 2011 and 2012.

Our gross profit percentage has also been negatively affected in the past and could continue to be negatively affected by an increase in manufacturing costs, a shift in our sales mix towards our less profitable products, increased customer demand for longer product warranties and increased cost pressures as a result of increased competition. Acquisitions of new businesses could also negatively affect our gross profit percentage, which could cause an adverse effect on our results of operations.

**The growth in our product portfolio means that we have to service and support more products. This may result in an increase in our expenses and an adverse effect on our results of operations.**

The size of our product portfolio has increased and continues to increase. As a result, we are required to provide to our customers sales support. Customers have requested that we provide a contractual commitment to support a product for a specified period of time. This period of time may exceed the working life of the product or extend past the period of time that we may intend to manufacture or support a product. We are dependent on our suppliers for the components (hardware and software) needed to provide support and may be unable to secure the components necessary to satisfy our service commitments. We do not have long-term contracts with our suppliers, and they may not be obligated to provide us with products or services for any specified period of time. We may need to purchase an inventory of replacement components and parts in advance in order to try to provide for their availability when needed. This could result in an increased risk of write-offs with respect to our replacement component inventory to the extent that we cannot accurately predict our future requirements under our customer service contracts. If any of our component suppliers cease production, cease operations or refuse or fail to make timely delivery of orders, we may not be able to meet our contractual commitments for product support. We may be required to supply enhanced components or parts as substitutes if the original versions are no longer available. Product support may be costly and any extra service revenues may not cover the hardware and software costs associated with providing long-term support.

**Terrorist attacks, or the threat of such attacks, may negatively impact the global economy which may materially adversely affect our business, financial condition and results of operation and may cause our share price to decline.**

Financial, political, economic and other uncertainties following terrorist attacks throughout the world may negatively impact the global economy. As a result, many of our customers and potential customers have become much more cautious in setting their capital expenditure budgets, thereby restricting their telecommunications procurement. Uncertainties related to the threat of terrorism have had a negative effect on global economy, causing businesses to continue slowing spending on telecommunications products and services and further lengthen already long sales cycles. Any escalation of these threats or similar future events may disrupt our operations or those of our customers, distributors and suppliers, which could adversely affect our business, financial condition and results of operations.

**We are subject to taxation in several countries.**

Because we operate in several countries, mainly in the United States, Israel, the United Kingdom, Singapore and Brazil, we are subject to taxation in multiple jurisdictions. We are required to report to and are subject to local tax authorities in the countries in which we operate. In addition, our income that is derived from sales to customers in one country might also be subject to taxation in other countries. We cannot be sure of the amount of tax we may become obligated to pay in the countries in which we operate. The tax authorities in the countries in which we operate may not agree with our tax position. Our tax benefits from carry forward losses and other tax planning benefits such as Israeli approved enterprise programs, may prove to be insufficient due to Israeli tax limitations, or may prove to be insufficient to offset tax liabilities from foreign tax authorities. Foreign tax authorities may also use our gross profit or our revenues in each territory as the basis for determining our income tax, and our operating expenses might not be considered for related tax calculations, which could adversely affect our results of operations.

#### ***Risks Related to Operations in Israel***

**Conditions in Israel affect our operations and may limit our ability to produce and sell our products and instability in the Middle East may adversely affect us.**

We are incorporated under the laws of the State of Israel, and our principal executive offices and principal research and development facilities are located in the State of Israel. Political, economic and military conditions in Israel directly affect our operations. There has been an increase in unrest and terrorist activity in Israel, which has continued with varying levels of severity for many years through the current period of time. This has led to ongoing hostilities between Israel, the Palestinian Authority, other groups in the West Bank and Gaza Strip, and the northern border of Lebanon, such as the hostilities along Israel's border with the Gaza Strip and the missiles fired from the Gaza Strip into Israel in 2012. The future effect of this violence on the Israeli economy and our operations is unclear. The Israeli-Palestinian conflict may also lead to political instability between Israel and its neighboring countries. Ongoing violence between Israel and the Palestinians, as well as tension between Israel and the neighboring countries, may have a material adverse effect on our business, financial conditions and results of operations.

Recent political events in various countries in the Middle East have weakened the stability of those countries, which may result in extremists coming to power. This instability may lead to deterioration of the political and trade relationships that exist between the State of Israel and these countries. In addition, this instability may affect the global economy and marketplace through changes in oil and gas prices. Our headquarters and research and development facilities are located in the State of Israel. Any events that affect the State of Israel may impact us in unpredictable ways. We have contingent plans for alternative manufacturing and supply sources, but these plans may be insufficient. Should our operations be impacted in a significant way, this may adversely affect the results of our operations.

We cannot predict the effect on us of an increase in these hostilities or any future armed conflict, political instability or violence in the region. Additionally, some of our officers and employees in Israel are obligated to perform annual military reserve duty and are subject to being called for additional active duty under emergency circumstances. Some of our employees live within conflict area territories and may be forced to stay at home instead of reporting to work. We cannot predict the full impact of these conditions on us in the future, particularly if emergency circumstances or an escalation in the political situation occur. If many of our employees are called for active duty, or forced to stay at home, our operations in Israel and our business may be adversely affected. Additionally, a number of countries continue to restrict or ban business with Israel or Israeli companies, which may limit our ability to make sales in those countries.

**We are adversely affected by the devaluation of the U.S. dollar against the New Israeli Shekel and could be adversely affected by the rate of inflation in Israel.**

We generate substantially all of our revenues in U.S. dollars and, in 2012, a significant portion of our expenses, primarily salaries, related personnel expenses and the leases of our buildings in Israel, were incurred in NIS. We anticipate that a significant portion of our expenses will continue to be denominated in NIS.

Our NIS related costs, as expressed in U.S. dollars, are influenced by the exchange rate between the U.S. dollar and the NIS. During 2010 and 2012, the NIS appreciated against the U.S. dollar, which resulted in a significant increase in the U.S. dollar cost of our operations in Israel. During 2011, the NIS depreciated against the U.S. dollar, which resulted in a decrease in the U.S. dollar cost of our operations in Israel. To the extent the U.S. dollar weakens against the NIS, we could experience an increase in the cost of our operations, which are measured in U.S. dollars in our financial statements, which could adversely affect our results of operations. In addition, in periods in which the U.S. dollar appreciates against the NIS, we bear the risk that the rate of inflation in Israel will exceed the rate of such devaluation of the NIS in relation to the U.S. dollar or that the timing of such devaluations were to lag considerably behind inflation, which will increase our costs as expressed in U.S. dollars.

The decrease in value of the U.S. dollar in relation to the NIS has and may continue to have the effect of increasing the cost in U.S. dollars of these expenses. Our U.S. dollar-measured results of operations were adversely affected in 2010 and 2012. This could happen again if the U.S. dollar were to decrease in value against the NIS.

In order to manage the risks imposed by foreign currency exchange rate fluctuations, from time to time, we enter into currency forward and put and call options contracts to hedge some of our foreign currency exposure. We can provide no assurance that our hedging arrangements will be effective. In addition, if we wish to maintain the U.S. dollar-denominated value of our products in non-U.S. markets, devaluation in the local currencies of our customers relative to the U.S. dollar may cause our customers to cancel or decrease orders or default on payment.

Because exchange rates between the NIS and the U.S. dollar fluctuate continuously, exchange rate fluctuations have an impact on our profitability and period-to-period comparisons of our results of operations. In 2012, the value of the U.S. dollar decreased in relation to the NIS by 2.3% and the inflation rate in Israel was 1.4%. In 2011, the value of the U.S. dollar increased in relation to the NIS by 7.7%, and the inflation rate in Israel was 2.2%. Our results of operations may be adversely affected in case of any significant fluctuations.

**The Israeli government programs in which we currently participate, and the tax benefits we currently receive require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs.**

Currently there are four programs under the Israeli Law for the Encouragement of Capital Investments, 1959, or the Investment Law, that entitle us to certain tax benefits. Our facilities in Israel have been granted Approved Enterprise status under the Investment Law and we have four programs that qualify as Privileged Enterprises pursuant to an amendment to the Investment Law that came into effect in April 2005. Among other things, the Investment Law, as amended in 2005, provides tax benefits to both local and foreign investors and simplifies the approval process. Such amendments do not apply to investment programs approved prior to December 31, 2004. Therefore, our Approved Enterprise program is not subject to the provisions of the amendment, but our four Privileged Enterprise programs are subject to the amendment.

In order to be eligible for tax benefits under the Investment Law, our Approved Enterprise and Privileged Enterprises must comply with various conditions set forth in the Investment Law and the criteria set forth in the applicable certificate of approval for the Approved Enterprise, as well as periodic reporting obligations. If we fail to meet these requirements, we would be subject to corporate tax in Israel at the regular statutory rate. Additionally, some of these programs and the related tax benefits are available to us for a limited number of years, and these benefits expire from time to time. We could also be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index. See Note 14 to our Consolidated Financial Statements for additional information with respect to tax benefits under the Investment Law.

If the Government of Israel discontinues or modifies these programs and potential tax benefits, our business, financial condition and results of operations could be materially and adversely affected.

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

In connection with research and development grants we received from the Office of the Chief Scientist of the Israeli Minister of Industry, Trade and Labor, or the OCS, we must pay royalties to the OCS on the revenue derived from the sale of products, technologies and services developed with the grants from the OCS. The terms of the OCS grants and the law pursuant to which grants are made restrict our ability to manufacture products or transfer technologies developed outside of Israel if OCS grants funded the development of the products or technology. An amendment to the relevant law facilitates the transfer of technology or know-how developed with the funding of the OCS to third parties outside of Israel, but any future transfer would still require the approval of the OCS, which may not be granted, and is likely to involve a material payment to the OCS. This restriction may limit our ability to enter into agreements for those products or technologies without OCS approval. We cannot be certain that any approval of the OCS will be obtained on terms that are acceptable to us, or at all.

In order to meet specified conditions in connection with the grants and programs of the OCS, we have made representations to the Government of Israel concerning our Israeli operations. If we fail to meet the conditions related to the grants, including the maintenance of a material presence in Israel, or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund the grants previously received (together with an adjustment based on the Israeli consumer price index and an interest factor) and would likely be ineligible to receive OCS grants in the future. In addition, manufacturing products outside the State of Israel (as we currently do) increases the rates of royalties to be paid to the OCS. Any inability to receive these grants would result in an increase in our research and development expenses.



In 2012, we recognized a royalty-bearing grant of \$2.7 million from the Government of Israel, through the OCS, for the financing of a portion of our research and development expenditures in Israel. The OCS budget has been subject to reductions, which may affect the availability of funds for these prospective grants and other grants in the future. As a result, we cannot be certain that we will continue to receive grants at the same rate, or at all. In addition, the terms of any future OCS grants may be less favorable than our past grant. As of December 31, 2012, we have a contingent obligation to pay royalties in the amount of approximately \$29.4 million.

**It may be difficult to enforce a U.S. judgment against us, our officers and directors, assert U.S. securities law claims in Israel or serve process on substantially all of our officers and directors.**

We are incorporated in Israel. Most of our executive officers and directors are nonresidents of the United States, and a majority of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any such persons or to effect service of process upon these persons in the United States. 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. Additionally, there is doubt as to the enforceability of civil liabilities under the Securities Act and the Exchange Act in original actions instituted in Israel.

**Israeli law may delay, prevent or make difficult a merger with or an acquisition of us, which could prevent a change of control and therefore depress the price of our shares.**

Provisions of Israeli law may delay, prevent or make undesirable a merger or an acquisition of all or a significant portion of our shares or assets. Israeli corporate law regulates acquisitions of shares through tender offers and mergers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law could have the effect of delaying or preventing a change in control and may make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions may limit the price that investors may be willing to pay in the future for our ordinary shares. In addition, our articles of association contain certain provisions that may make it more difficult to acquire us, such as a staggered board, the ability of our board of directors to issue preferred stock and limitations on business combinations with interested shareholders. Furthermore, Israel tax considerations may make potential transactions undesirable to us or to some of our shareholders.

#### ***Risks Relating to the Ownership of our Ordinary Shares***

**The price of our ordinary shares may fluctuate significantly.**

The market price for our ordinary shares, as well as the prices of shares of other technology companies, has been volatile. Between January 1, 2009 and April 3, 2013, our share price has fluctuated from a low of \$0.92 to a high of \$8.07. The following factors may cause significant fluctuations in the market price of our ordinary shares:

- fluctuations in our quarterly revenues and earnings or those of our competitors;
- shortfalls in our operating results compared to levels forecast by securities analysts or by us;
- announcements concerning us, our competitors or telephone companies;
- announcements of technological innovations;

- the introduction of new products;
- changes in product price policies involving us or our competitors;
- market conditions in the industry;
- integration of acquired businesses, technologies or joint ventures with our products and operations;
- the conditions of the securities markets, particularly in the technology and Israeli sectors; and
- political, economic and other developments in the State of Israel and worldwide.

In addition, stock prices of many technology companies fluctuate significantly for reasons that may be unrelated or disproportionate to operating results. The factors discussed above may depress or cause volatility of our share price, regardless of our actual operating results.

**Our quarterly results of operations have fluctuated in the past and we expect these fluctuations to continue. Fluctuations in our results of operations may disappoint investors and result in a decline in our share price.**

We have experienced and expect to continue to experience significant fluctuations in our quarterly results of operations. In some periods, our operating results may be below public expectations or below revenue levels and operating results reached in prior quarters or in the corresponding quarters of the previous year. If this occurs, the market price of our ordinary shares could decline.

The following factors have affected our quarterly results of operations in the past and are likely to affect our quarterly results of operations in the future:

- size, timing and pricing of orders, including order deferrals and delayed shipments;
- launching of new product generations;
- length of approval processes or market testing;
- technological changes in the telecommunications industry;
- competitive pricing pressures;
- the timing and approval of government research and development grants;
- accuracy of telecommunication company, distributor and original equipment manufacturer forecasts of their customers' demands;
- changes in our operating expenses;
- disruption in our sources of supply;
- temporary or permanent reduction in purchases by our significant customers; and
- general economic conditions.

Therefore, the results of any past periods may not be relied upon as an indication of our future performance.

**Our actual financial results might vary from our publicly disclosed financial forecasts.**

From time to time, we publicly disclose financial forecasts. Our forecasts reflect numerous assumptions concerning our expected performance, as well as other factors which are beyond our control and which might not turn out to be correct. As a result, variations from our forecasts could be material. Our financial results are subject to numerous risks and uncertainties, including those identified throughout this "Risk Factors" section and elsewhere in this Annual Report. If our actual financial results are worse than our financial forecasts, the price of our ordinary shares may decline.

**It is our policy that we will not provide quarterly forecasts of the results of our operations. This policy could affect the willingness of analysts to provide research with respect to our ordinary shares which could affect the trading market for our ordinary shares.**

It is our policy that we will generally not provide quarterly forecasts of the results of our operations. This could result in the reduction of research analysts who cover our ordinary shares. Any reduction in research coverage could affect the willingness of investors, particularly institutional investors, to invest in our shares which could affect the trading market for our ordinary shares and the price at which our ordinary shares are traded.

**As a foreign private issuer whose shares are listed on NASDAQ, we follow certain home country corporate governance practices instead of certain NASDAQ requirements.**

As a foreign private issuer whose shares are listed on NASDAQ, we are permitted to follow certain home country corporate governance practices instead of certain requirements contained in the NASDAQ listing rules. We do not comply with the NASDAQ requirement that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans. Instead, we follow Israeli law and practice which permits the establishment or amendment of certain equity based compensation plans to be approved by our board of directors without the need for a shareholder vote, unless such arrangements are for the compensation of directors or the chief executive officer, in which case they also require compensation committee and shareholder approval.

As a foreign private issuer listed on the NASDAQ, we may also elect in the future to follow home country practice with regard to, among other things, director nomination, composition of the board of directors and quorum at shareholders' meetings, as well as not obtain shareholder approval for certain dilutive events.

Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

**Our ordinary shares are listed for trading in more than one market and this may result in price variations.**

Our ordinary shares are listed for trading on NASDAQ and on the Tel Aviv Stock Exchange ("TASE"). Trading in our ordinary shares on these markets is made in different currencies (U.S. dollars on NASDAQ and New Israeli Shekels on TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Actual trading volume on the TASE is generally lower than trading volume on NASDAQ, and as such could be subject to higher volatility. The trading prices of our ordinary shares on these two markets often differ resulting from the factors described above, as well as differences in exchange rates. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

**We do not anticipate declaring any cash dividends on our ordinary shares.**

We have never declared or paid cash dividends on our ordinary shares and do not plan to pay any cash dividends in the near future.

**U.S. shareholders face certain income tax risks in connection with their acquisition, ownership and disposition of our ordinary shares. In any tax year, we could be deemed a passive foreign investment company, which could result in adverse U.S. federal income tax consequences for U.S. shareholders.**

Based on the composition of our gross income, the composition and value of our gross assets and the amounts of our liabilities during each of 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011 and 2012, we do not believe that we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes during any of such tax years. It is likely, however, that we would be deemed to have been a PFIC in each of 2001, 2002 and 2003. There can be no assurance that we will not be deemed a PFIC for any future tax year in which, for example, the value of our assets, as measured by the public market valuation of our ordinary shares, declines in relation to the value of our passive assets (generally, cash, cash equivalents and marketable securities). If we are a PFIC for any tax year, U.S. shareholders who own our ordinary shares during such year may be subject to increased U.S. federal income tax liabilities and reporting requirements for such year and succeeding years, even if we are no longer a PFIC in such succeeding years. Under legislation enacted by the U.S., a U.S. holder of our ordinary shares will be required to file an information return containing certain information required by the U.S. Internal Revenue Service for each year in which we are treated as a PFIC.

We urge U.S. holders of our ordinary shares to carefully review Item 10E. – “Taxation - United States Tax Considerations - United States Federal Income Taxes” in this Annual Report and to consult their own tax advisors with respect to the U.S. federal income tax risks related to owning and disposing of our ordinary shares and the consequences of PFIC status.

**We are subject to ongoing costs and risks associated with complying with extensive corporate governance and disclosure requirements.**

As a foreign private issuer subject to U.S. federal securities laws, we spend a significant amount of management time and resources to comply with laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, SEC regulations and NASDAQ rules. Section 404 of the Sarbanes-Oxley Act requires management’s annual review and evaluation of our internal control over financial reporting and attestations of the effectiveness of these controls by our management and by our independent registered public accounting firm. There is no guarantee that these efforts will result in management assurance or an attestation by our independent registered public accounting firm that our internal control over financial reporting is adequate in future periods. In connection with our compliance with Section 404 and the other applicable provisions of the Sarbanes-Oxley Act, our management and other personnel devote a substantial amount of time, and may need to hire additional accounting and financial staff, to assure that we comply with these requirements. The additional management attention and costs relating to compliance with the Sarbanes-Oxley Act, the Dodd-Frank Act and other corporate governance requirements could materially and adversely affect our financial results.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

AudioCodes Ltd. was incorporated in 1992 under the laws of the State of Israel. Our principal executive offices are located at 1 Hayarden Street, Airport City, Lod, 7019900 Israel. Our telephone number is +972-3-976-4000. Our agent in the United States is AudioCodes Inc., 27 World’s Fair Drive, Somerset, New Jersey 08873.

## Major Developments since January 1, 2012

MailVision Ltd. is an Israeli company which develops, markets and licenses VoIP solutions for mobile, PC, web and tablet devices for telecom operators and service providers. We resell and market MailVision's products and services. Since 2006, we have extended net loans and convertible loans to MailVision in the aggregate principal amount of \$1,064,000, including loans in the principal amount of \$211,000 in 2011 and \$183,000 in 2012. These loans bear interest at the rate of LIBOR plus 0.5%-5% per annum and are convertible into shares of MailVision. In November 2010 and June 2011, \$666,000 in principal amount of these loans was converted by us into shares of MailVision. As of December 31, 2012, we owned 26.4% of the outstanding share capital of MailVision, or 24.1% of the share capital of this company on a diluted basis, compared to owning 26.6% of the outstanding share capital as of December 31, 2011, or 24.8% of the share capital of MailVision on a diluted basis. As of December 31, 2012, there was \$398,000 in principal amount of these loans outstanding.

In April 2013, we entered into an asset purchase agreement with MailVision. The closing of the transaction is subject to customary conditions and is expected to occur during May 2013. Pursuant to this agreement, AudioCodes has agreed to acquire certain of MailVision's assets for the following consideration: (1) \$233,000 to be payable 12 months following the closing date; and (ii) additional earn out payments will be paid to MailVision subject to the achievement of a certain level of net revenues from the sale of MailVision's products. Payment can be made, at our discretion, in either cash or our ordinary shares. As additional consideration for the transaction, on closing, we have agreed to waive repayment of any outstanding loans made by us to MailVision and to assume specified liabilities of MailVision in the aggregate amount of approximately \$1,300,000.

In January 2010, we entered into an agreement to acquire all of the outstanding equity of Natural Speech Communication Ltd., or NSC, that we did not own as of December 31, 2009. The closing of the transaction occurred in May 2010. Pursuant to the agreement, we purchased the remaining 40.3% of the shares from NSC's non-controlling shareholders with a maximum total consideration payable in the aggregate amount of \$1,733,000, if certain aggregate revenue milestones were met for 2010, 2011 and 2012, in any combination, at our option, of cash and our shares. As a result, we paid \$224,000 in 2010, \$278,000 in 2011, \$336,000 in 2012 and 395,000 in 2013 in connection with this acquisition. Additional consideration of \$120,000 is payable by us in 2013.

Since January 1, 2012, AudioCodes invested in the following key product lines and solutions to address the following market segments:

- *Mobile Clients and Mobility Server for PBX, IP-PBX and Unified Communications Systems:* We launched MobilityPLUS, an integrated enterprise solution that extends the feature set of enterprise telephony and unified communications systems to leading smart phone platforms. Leveraging existing enterprise WiFi or 3G/4G data services, MobilityPLUS enhances enterprise employee productivity with "anytime/anywhere" connectivity resulting in improved efficiencies of business operations. MobilityPLUS interoperates with market leading PBXs and IP-PBXs, as well as with integrated unified communications systems, such as Microsoft Lync 2010. MobilityPLUS includes a mobile client designed for enterprise users, supporting enterprise voice features as well as instant messaging and presence. MobilityPLUS leverages AudioCodes Mediant business gateway and ESBC, together with an embedded mobility application. The MobilityPLUS mobile client is available for Apple iOS and Android OS. A Windows version is estimated to be released in 2013.
- *Extended Connectivity, Survivability and Call Recording Solution for Microsoft Lync Deployments:* An additional extension of our product range specifically designed for the Microsoft unified communications environment now includes Mediant800 Survivable Branch Appliance (SBA), a cost-effective survivable branch solution for small locations, Mediant3000 Enhanced Gateway and Mediant4000 SBC, supporting large enterprise customers that need high capacity, highly available media gateways, session border controllers and SmartTAP, a secure call recording solution that enables the recording of key business interactions within the Microsoft Unified Communication environment, including Microsoft Lync and Office Communications Server R2. SmartTAP is targeting companies in the financial services sector, as well as other highly regulated industries, providing compliance recording as well as a complete call recording solutions for mitigating liability, customer disputes, and quality assurance. SmartTAP can be installed on stand-alone servers, or alternatively integrated into the AudioCodes Mediant 1000 platform, that is also qualified as a Microsoft Enhanced Gateway and Survivable Branch Appliance. These products are intended to further extend our value proposition to our growing network of Microsoft VSPs (voice specialized partners) with whom we work closely.

We further extended our portfolio for Microsoft Lync solution to meet Lync 2013 specifications, including official qualifications of an internet protocol called IPv6. Additional key developments for Microsoft Lync include ELIN gateway functionality, supporting emergency (E911) calls and enhancing management capabilities with SCOM 2012 which is a management pack allowing Microsoft System Center Operation to monitor AudioCodes enhanced gateways, session border controllers and SBAs.

- *Software Enterprise Session Border Controller*: In March, 2012, we announced the launch of our Software Enterprise Session Border Controller (SBC), a software only member of our SBC product family. Enterprises deploying the software SBC benefit from connectivity to SIP trunking services, high VoIP quality and network security. As a software only solution, the Software SBC smoothly integrates into data center environments, and addresses the needs for scalability and connectivity of unified communications and contact center deployments. In 2012, we also announced the virtualized version of the Mediant Software SBC which allows end customers the flexibility of running the SBC on their virtualized server environment.
- *Session Experience Manager (SEM)*: In March 2012, we announced the launch of our Session Experience Manager, a new software solution built to monitor, analyze, report and control the quality of incoming and outgoing enterprise voice calling over Internet Protocol networks in real-time. SEM is designed as an intuitive, easy to use solution, which includes an array of advanced tools producing a continuous comprehensive view of voice quality of experience at the enterprise network and its connecting trunks. Among these tools are network views to map devices and their associated voice quality, graphic illustrations of VoIP call metrics, convenient drill down details of a given call, traffic trend analysis to identify current and future bottlenecks, active and historic alarm display, and flexible pre-defined reports. In addition to VoIP, SEM includes a tool for analyzing fax transmission quality. SEM complements our Element Management System (EMS) for comprehensive configuration, monitoring and performance solution for IT managers and service providers deploying a network of AudioCodes network products. In 2012, we also launched a virtualized version of SEM enabling the product to run in virtualized data center deployments and enhanced its network visualization and reporting capabilities to allow the SEM user to immediately monitor the status of the VoIP network and identify areas suffering from low voice quality.
- *IP Phones for Microsoft Lync and Contact Centers*: To further open up opportunities at Microsoft Lync and contact center deployments, we launched the HD4XX family of IP Phones, featuring updated design and improved voice quality. These phones support interoperability with Microsoft Lync and provide advanced security, resiliency and login capabilities for the Contact Center space. Our HD4XX IP Phones offer multiple hardware configurations and capabilities at a competitive price.
- *Mediant 4000 Session Border Controller (SBC)*: In 2012, we launched a high capacity scalable SBC product intended for large enterprise deployments, as well as hosted and access environments, of up to 4000 concurrent sessions, supporting enhanced security, interoperability and advanced monitoring of voice quality. We also extended the integrated transcoding capacity of the Mediant4000 SBC to 1000 concurrent transcoding sessions. This extension allows enterprises to connect to lower cost SIP trunks using voice compression, as well as provide connectivity between disparate unified communications or IP PBX systems utilizing different voice compression schemes.

- *Multi-Service-Business-Routers*: We have added two new products to our Multi-Service-Business-Routers portfolio to cost effectively address different business sizes and deployment scenarios. The Mediant500 addresses the pure hosted and cloud deployments, while the Mediant850 targets the larger SIP trunk installations. Both provide a wide choice of broadband WAN interfaces featuring sustained high capacity routing performance and support optional WiFi integration and enhanced data resiliency with WAN backup. The Mediant MSBR includes integrated SBC for secure and interoperable IP-PBX to SoftSwitch SIP trunking and advanced VoIP resiliency for cloud installations
- *VoIP Network Assessment (VNA)*: During 2012 we introduced a new professional service module of VoIP Network Assessment for enterprises. The VNA is provided to enterprises seeking a smooth and high quality transition to deployment of unified communications (e.g., Microsoft Lync) and IP Contact Centers. The VNA provides the customer an understanding of its current IP network capability and readiness to carry high quality VoIP traffic on top of data services. By developing comprehensive tools for active VoIP call generation and utilizing SEM capabilities, our VNA is able to load the target network with VoIP traffic simulating the intended usage and services. The VNA module is operated by our VoIP experts who study the customer's network topology in detail and install assessment probes at the appropriate strategic locations to confirm the assessment is running the target traffic characteristics. The last stage of the VNA is analysis and a detailed yet intuitive report to help the customer decide the proper network adjustments required prior to the deployment.
- *MP26X*: In 2012, we launched the next generation of our residential gateway line, the MP26x, supporting VDSL interfaces for high speed internet connectivity and Gigabit Ethernet LAN interfaces to meet the demanding requirements of today's home networks.
- *Professional Services*. During 2012 we placed increasing focus on professional services. To support today's complex multi-service networks, AudioCodes has developed a comprehensive professional services program intended to provide responsive, preventive, and consultative support of AudioCodes networking products. AudioCodes professional services support networking devices, applications and infrastructures, allowing large organizations and service providers to realize the potential of a high-performance multi-service network. The foundation for AudioCodes professional services is a network life-cycle model based on the four basic phases of planning, design, implementation and optimization . The result is a specially designed portfolio of complementary and synergistic service components.

### **Principal Capital Expenditures**

We have made and expect to continue to make capital expenditures in connection with expansion of our production capacity. The table below sets forth our principal capital expenditures incurred for the periods indicated (amounts in thousands):

	<b>Year Ended December 31</b>		
	<u>2010</u>	<u>2011</u>	<u>2012</u>
Computers and peripheral equipment	\$ 572	\$ 1,420	\$ 1,619
Office furniture and equipment	693	148	353
Leasehold improvements	<u>304</u>	<u>11</u>	<u>34</u>
<b>Total</b>	<u>\$ 1,569</u>	<u>\$ 1,579</u>	<u>\$ 2,006</u>

## Introduction

We design, develop and sell products and services for voice and data over packet networks. In broad terms, voice over packet, or VoP, networks consist of key network elements such as software switches, application servers, IP phones, media gateways and session border controllers (SBC). Our products primarily provide the media gateway and SBC element in the network, as well as voice over Internet protocol, or VoIP, end-points such as IP Phones and VoIP mobile clients. Multi-service business routers integrate media gateway functionality with data routing and network access. The media gateways connect legacy and IP networks. They essentially receive the legacy format of communication and convert it to an IP communication and vice versa. Typically, media gateways utilize compression algorithms to compress the amount of information and reduce the amount of bandwidth required to convey the information (for example, a voice communication). With the industry migration to an end-to-end IP network, media gateways evolved into SBC, now also connect between different VoIP networks, providing security, interoperability, resiliency and voice quality functionality.

Voice over IP gateway and SBC equipment can be generally segmented into three classes: service providers' gateways and SBCs for use in central office facilities, enterprise gateways and SBCs for use by corporations and in small offices, and residential gateways for use in homes. In addition to the gateway element, which connects legacy voice equipment to an IP network, there is growth in native VoIP end user equipment, primarily including IP phones, soft phones and VoIP mobile clients, running on desktop PCs or portable devices such as cellular phones, smart phones, tablets, laptops, and other devices that have wireless IP connectivity running over WiFi or cellular data networks.

The need to re-route voice and fax traffic from the traditional circuit-switched networks onto the new packet networks has led to the development of interface equipment between the two networks, generally referred to as media gateways. The processing of voice and fax signals in gateway and access equipment is done according to industry-wide standards. These standards are needed to ensure that all traditional telephony traffic is seamlessly switched and routed over the packet network and vice versa. The industry migration into a network that is utilizing IP end-to-end has also created a need for a new functionality to mediate between different VoIP networks. This includes protocol translation as well as security services, business continuity and voice quality enforcement and is provided by stand-alone SBCs as well as Enterprise SBC (E-SBC) functionality integrated into the gateway.

Packet networks differ fundamentally from circuit-switched networks in that the packet network's resources and infrastructure can be shared simultaneously by several users and bandwidth can be flexibly allocated. Packet-based communications systems format the information to be transmitted, such as e-mail, voice, fax and data, into a series of smaller digital packages of information called packets. Each of these packets is then transmitted over the network and is reassembled as a complete communication at the receiving end. The various packet networks employ different network protocols for different applications, priority schemes and addressing formats to ensure reliable communication.

Packet networks offer a number of advantages over circuit-switched networks. Rather than requiring a dedicated circuit for each individual call, packet networks commingle packets of voice, fax and data from several communications sources on a single physical link. This provides superior utilization of network resources, especially in dealing with information sources with bursts of information followed by periods of silence. This superior utilization means that more traffic can be carried over the same amount of network resources.



The integration of voice and data communications makes possible an enrichment of services and an entire range of new, value-added applications, such as unified communications and voice-enabled web sites. In addition, voice traffic over packet networks is usually compressed to provide a further reduction in the use of or demand for bandwidth. Another recent trend in the VoIP environment, referred to as High Definition VoIP, or HD VoIP, now enables the improvement of voice quality. The adoption of both VoIP technology and broadband networks has enabled the development and deployment of high-quality voice coding algorithms that make communication more efficient, effective and natural. HD VoIP allows carriers to differentiate their services with an improved audio experience, with the goal of creating customer loyalty and affinity. It also enables enterprises to provide better, clearer voice services for their employees, which we believe makes them more productive and makes it easier to work across different cultures and accents.

As customers integrate more services into their IP network, they tend to use integrated products that provide all the services they need in one box. Multi-service business routers, or MSBRs, combine all the capabilities of media gateways and session border controllers with the support of native data switching and routing. The MSBR enables enterprise customers to connect their branch office networks into the corporate headquarters, and service providers to connect their customers into their network data and voice services. Some MSBRs also include an integrated server which can run off-the-shelf applications such as unified communications. This combination enables system integrators and service providers to provide a fully integrated solution for small/medium businesses and enterprise branches, or SMB/E, that includes the voice and data infrastructure and the application in one device.

Moving into the VoIP world, enterprise and service providers have started to use a new breed of phone devices that inherently produce packets instead of legacy voice, called IP phones. The IP phone is an advanced telephone that connects into the network using VoIP over Ethernet instead of using analog TDM interfaces. Most enterprise telephony systems sold today use IP phones, as well as service providers managed services such as IP Centrex.

In addition to wireline IP telephony, mobile networks have started to use VoIP as well. Mobile VoIP clients, running on smart-phones enable cost effective mobile roaming and allow Internet telephony service providers, or ITSPs, to enter the mobile space. These include mobile VoIP clients for leading smartphones operating systems, such as iOS, Android, Symbian and Windows phones.

## **Industry Background**

### *Market Trends*

The networking and telecommunications industries have experienced rapid change over the last few years. The primary factors driving this change include the following:

- *New technologies.* The increase of speed and the proliferation of broadband access technologies alongside related technologies, such as new high definition voice compression algorithms, quality of service mechanisms and security and encryption algorithms and protocols, have enabled delivery of voice over packet to residential and enterprise customers with more reliability, higher quality and greater security. Examples of these broadband access technologies include: third generation cellular, WiMax, LTE, WiFi, data over cable, digital subscriber line technologies and fiber networks (FTTx). Packet technologies enable delivery of real time and non-real time services by different service providers that do not necessarily own the access network or the part of the network through which the subscriber accesses the network. This allows for the growth of alternative or virtual service providers that do not own an access network.

- *Competition by alternative service providers with incumbent and traditional service providers.* Competition by alternative service providers is causing incumbents to deploy advanced broadband access technologies and increase their competitiveness by offering bundled services to their subscribers, such as voice, video and data, and online gaming. In addition, the emergence of wide band vocoders that use a higher sampling rate than used in legacy time domain multiplexing, or TDM, networks allows service providers to offer higher quality voice and music over their newly established IP network.
- *Increasing need for peering between VoIP networks.* Service providers and enterprises are increasingly building out VoIP networks. As a result, there is an increasing need to connect between two VoIP networks. In order to interconnect between two VoIP networks, service providers and enterprises need session border controllers to provide connectivity and security.
- *Increased use of open source codes for enterprise telephony.* Similar to the trend experienced with respect to Linux in the IT world, open source has started to gain momentum in the VoIP space as well. Open source based IP telephony solutions, led by Asterisk, a well known IP-PBX implementation, has been penetrating the enterprise space as a low cost alternative to the proprietary IP-PBX solutions from the large vendors. The adoption of open source IP telephony solutions is gaining momentum mainly in the SMB/SME space, as well as with service providers and developers that add their own code on top of the open source basic code to enable special services and features.
- *Unified communications in the enterprise.* With the move to VoIP and the network integration between voice and data based on Ethernet and IP, enterprises can easily move into a unified communications network. Unified communications networks integrate all means of communications into a single experience, providing on line (voice, data, instant messaging) and off line (voice mail, email and fax) integration into the same device. The devices can be PCs, desktop phones or mobile smartphones and tablets.
- *Mobility.* Mobile smartphones have become popular among business professionals as well as the general public. Smartphones, running advanced operating systems such as Symbian, Windows phone, Android and iOS, include high CPU power, large storage space, integrated WiFi and cellular data, as well as the ability to run high performance multimedia applications. Mobile VoIP is one of these applications, allowing cost-effective roaming for a service provider's customers and enterprise mobility services.
- *Cloud Computing.* The emergence of cloud computing services also affects the communications world. Leading unified communication vendors offer their hosted services on the cloud as an alternative to enterprise owned systems. This includes solutions such as Microsoft Office 365, IP Centrex services by telecom providers and quality of experience monitoring solutions such as Broadsoft PacketSmart.
- *Software.* The significance of software only products for the telecommunications market is increasing as operators and enterprises are seeking to move away from dedicated hardware platforms onto common generic computing platforms that are enabling data centers. These computing platforms, are running software-only communications systems in various modes of shared resources and virtualization.

### *The Challenges*

Despite the inherent advantages and the economic attractiveness of packet voice networking, the transmission of packet voice and fax poses a variety of technological challenges. These challenges relate to quality of service, reliability of equipment, functionality and features, and ability to provide a good return on investment.

- *Quality of Service.* The most critical issues leading to poor quality of service in the transmission of voice and fax over packet networks are packet loss, packet delay and packet delay jitter. For real time signals like voice, the slightest delay in the arrival of a packet may render that packet unusable and, in a voice transmission, the delayed packet is considered a lost packet. Delay is usually caused by traffic hitting congestion or a bottleneck in the network. The ability to address delay is compounded by the varying arrival times of packets, called packet-jitter, which results from the different routes taken by different packets. This jitter can be eliminated by holding the faster arriving packets until the slower arriving packets can catch up, but this introduces further delay. These idiosyncrasies of packet networks do not noticeably detract from the quality of data transmission since data delivery is relatively insensitive to time delay. However, even the slightest delay or packet loss in voice and fax transmission can have severe ramifications such as voice quality degradation or, in the case of a fax transmission, call interruption. Therefore, the need to compensate for lost or delayed packets without degradation of voice and fax quality is a critical issue. The rapid adoption of VoIP and unified communications in enterprise and contact centers intensifies voice quality and quality of service challenges. Enterprise and contact center data networks are typically not properly engineered or configured to support carrying high quality real time communication services in enterprise and contact centers. Such assessment typically requires high load simulations and advanced voice quality monitoring systems.
- *Service Reliability.* In order for a packet network to be efficient for voice or fax transmission, the VoIP equipment that is installed in core networks and enterprises must be able to deliver a high level of performance and reliability to ensure continuous service. Since data networks are more susceptible to outages compared to traditional voice networks, businesses relying on centralized or hosted communication services need to ensure resiliency in their headquarters and remote branches in case of data network failure.
- *Connectivity and Security.* In contrast with legacy circuit switched voice and video communications, IP-based communications are more susceptible to attacks, interceptions and fraud by unauthorized entities. In addition, the complexity and relative immaturity of IP networks and protocols pose significant quality of service and connectivity interoperability challenges when sessions cross between separate IP networks.
- *Functionality.* In order to effectively replace legacy circuit-switching equipment, packet network equipment must be able to deliver equivalent and improved functionality and features for the service providers and network users.
- *Return on Investment.* With the reduction in profitability of service providers there is an even greater need for them to achieve better returns on investment from capital expenditures on new equipment. Given the evolving nature of packet technologies and capabilities, there is greater pressure to provide cost-effective technological solutions.

In order to maximize the benefits of using packet networks for the transmission of voice, data and fax, products must be able to address and solve these inherent problems and challenges. These products must also be standards-based to support interoperability among different equipment manufacturers and to allow operation over various networks.

#### **AudioCodes' Solution**

Using our voice compression algorithms, industry standards, advanced digital signal processing techniques, VoIP control protocol and security expertise, and voice communications system design expertise, our products address interoperability challenges, quality of service problems, security problems and reliability problems facing the VoIP industry. As a result, we enable our customers to build voice over packet networks that provide communication quality comparable to traditional telephone networks. Using HDVoIP, voice quality can even surpass the quality of traditional TDM networks. We work closely with our customers in order to tailor our products to meet their specific needs, assist them in integrating our products within their networks and help them bring their systems into operation on a timely basis. We also work with our customers in deploying their systems in various network environments.

Utilizing our investment in developing standards-based VoIP protocol support for our products, customers can integrate our products with a large number of industry leading IP-PBXs, unified communications, contact centers and carrier soft switches. Our interoperability teams test our products against a variety of other products for interoperability, focusing on the leading standard VoIP protocols: Session Initiation Protocol, or SIP, and MEGACO/H.248.

We believe that the following strengths have enabled us to develop our products and provide services to our customers:

- *Leadership in voice compression technology.* We are a leader in voice compression technology. Voice compression exploits redundancies within a voice signal to reduce the bit rate of data required to digitally represent the voice signal while still maintaining acceptable voice quality. Our key development personnel have significant experience in developing voice compression technology. We were involved in the development of the ITU G.723.1 voice coding standard that was adopted by the VoIP Forum and the International Telecommunications Union as the recommended standard for use in voice over IP gateways. We implement industry voice compression standards and work directly with our customers to design state-of-the-art proprietary voice compression algorithms that satisfy specific network requirements. We believe that our significant knowledge of the basic technology permits us to optimize its key elements and positions us to address further technological advances in the industry. We also believe that our technological expertise has resulted in us being sought out by leading equipment manufacturers to work with them in designing their systems and provision of solutions to their customers.
- *Digital signal processing design expertise.* Our extensive experience and expertise in designing advanced digital signal processing algorithms enables us to implement them efficiently in real time systems. Digital signal algorithms are computerized methods used to extract information out of signals. In designing our signal processors, we use minimal digital signal processing memory and processing power resources. This allows us to develop higher density solutions than our competitors. Our expertise is comprehensive and extends to all of the functions required to perform voice compression, fax and modem transmission over packet networks and telephone signaling processing.
- *Compressed voice communications systems design expertise.* We have the expertise to design and develop the various building blocks and the products required for complete voice over packet systems. In building these systems, we develop hardware architectures, voice packetization software and signaling software, and integrate them with our signal processors to develop a complete, high performance compressed voice communications system. We assist our customers in integrating our signal processors into their hardware and software systems to ensure high voice quality, high completion rate of fax and data transmissions and telephone signaling processing accuracy. Further, we are able to customize our off-the-shelf products to meet our customers' specific needs, thereby providing them with a complete, integrated solution.
- *Real time embedded software design and implementation expertise.* We have the expertise to design and develop voice and data network elements using embedded real time software to achieve more competitive pricing. The development and integration of VoIP signaling protocols, routing protocols, management and provisioning into a more cost-effective solution uses our expertise and investment in research and development resources. We believe that the benefits we can deliver are better price performance, smaller footprint, reduced power consumption and more attractive products.
- *Media gateway protocols design expertise.* Our extensive experience in developing media gateway standard protocols, keeping ourselves up to date with new request for comments, or RFCs, and adjusting our features according to customers' requirements and interoperability testing allows us to provide our customers with a single gateway that can interface with most of the leading solution providers in the VoIP market.

- *Close technology relationships with market leaders.* Our continuing effort of testing and certifying our systems against other vendors' complimentary solutions, positions us as a provider of VoIP products that can interoperate with most of the world's leading VoIP products. It also helps to create for us an extensive feature list that can be used by different customers for their own networks and solutions.
- *Deep understanding of VoIP security.* Based on long-standing market experience with deploying AudioCodes products at enterprise networks, we have developed a detailed understanding of the VoIP security requirements of enterprises including admission control, denial of service, throttling and traversal aspects. This understanding and knowledge helps us reach integration with our communications protocols implementation creating an effective VoIP security solution.
- *VoIP professional services.* Based on our extensive expertise in VoIP network and technology we offer services intended to enhance customer's VoIP network capabilities, by offering network assessment services and other professional services.

We believe that our products possess the following advantages:

- *Voice over Packet signal processors.* Our multi-channel signal processors enable our customers and us to create products that meet the reliability, capacity, size, power consumption and cost requirements needed for building high capacity VoIP products.
- *Multiple and comprehensive product lines.* We address both the standards-based open telecommunications architecture market and the proprietary system market. We can do this because we enable our customers to use multiple applications in different market segments. For example, our VoIP communications boards target the open telecommunications architecture market, while our signal processors, modules and voice packetization software target the proprietary system market. Our analog and digital media gateways and multi-service business gateways target residential, hosted, access, trunking and enterprise applications and our session border controllers target unified communication, SIP trunking, IP centrex and contact center networks. Our IP phones and VoIP mobile clients target the enterprise and service provider hosted solutions markets.
- *Extensive feature set.* Our products incorporate an extensive set of signal processing functions and features (such as coders, fax processing and echo cancellation), functionalities (such as session initiation protocol, or SIP, H.248 or Megaco, H.323, and media gateway control protocol, or MGCP) and implement a complete system. We offer the ability to manage multiple channels of communications working independently of each other, with each channel capable of performing all of the functions required for voice compression, fax and modem transmission, telephone signaling processing and other functions. These functions include voice, fax or data detection, echo cancellation, telephone tone signal detection, generation and other telephony signaling processing. Our gateway products, media server and multi-service business gateways also offer wireless/mobile features to enable fixed mobile convergence.
- *Cost-effective solutions.* We are able to address different market segments and applications with the same hardware platforms thus providing our customers with efficient and cost-effective solutions.
- *Open architecture.* Our networking products utilize industry standard control protocols that enable them to interoperate with other vendors and easily integrate into enterprise IP telephony systems as well as carrier networks. Our voice over packet communications boards target the open architecture gateway market segment, which enables our customers to use hardware and software products widely available for standards-based open telecommunications platforms. We believe that this provides our customers the benefits of scalability, upgradeability and enhanced functionality without the need to replace their systems for evolving applications.

- *Various entry level products.* Our wide product range (chips to media gateways, multi-service business gateway, IP phones and media servers) provides our customers with a range of entry level products. We believe that these building blocks enable our customers to significantly shorten their time to market by adding their value added solution.
- *VoIPerfect architecture.* Our VoIPerfect architecture serves as the underlying technology platform common to all of our products since 1998. VoIPerfect™ is regularly updated and upgraded with features and functionalities required to comply with evolving standards and protocols. VoIPerfect™ architecture comprises VoIP digital signal processing, or DSP, software and media streaming embedded software, integrated public telephone switched network, or PTSN, signaling protocols and VoIP standard control protocols, VoIP security mechanisms, provisioning and management engines. Additional features enable carrier-grade quality and high availability. VoIPerfect™ architecture components are available in AudioCodes' products at various levels of integration, from the chip level, through blades, to high-availability and non-high-availability analog and digital gateway and session border controller platforms.

## **Business Strategy**

AudioCodes' vision is to become a leading strategic supplier of VoIP and converged VoIP and data solutions for service providers and enterprises worldwide. The following are key elements of our strategy:

- *Maintain and extend technological leadership.* We intend to capitalize on our expertise in voice compression technology and voice signaling protocols and proficiency in designing voice communications systems. We continually upgrade our product lines with additional functionalities, interfaces and densities. We have invested heavily and are committed to continued investment in developing technologies that are key to providing high performance voice, data and fax transmission over packet networks and to be at the forefront of technological evolution in our industry.
- *Strengthen and expand strategic relationships with key partners and customers.* We sell our products to leading enterprise channels, regional system integrators, global equipment manufacturers and value-added resellers, or VARs, in the telecommunications and networking industries and establish and maintain long-term working relationships with them. We work closely with our customers to engineer products and subsystems that meet each customer's particular needs. The long development cycles usually required to build equipment incorporating our products frequently results in close working relationships with our customers. By focusing on leading equipment manufacturers with large volume potential, we believe that we reach a substantial segment of our potential customer base while minimizing the cost and complexity of our marketing efforts.
- *Expand and enhance the development of highly-integrated products.* We plan to continue designing, developing and introducing new product lines and product features that address the increasingly sophisticated needs of our customers. We believe that our knowledge of core technologies and system design expertise enable us to offer better solutions that are more complete and contain more features than competitive alternatives. We believe that the best opportunities for our growth and profitability will come from offering a broad range of highly-integrated network product lines and product features, the integration of data services into our VoIP products, and the expansion into the unified communications and contact center markets.
- *Build upon existing technologies to penetrate new markets.* The technology we developed originally for the OEM market has served us in building products that now sell into the service provider and enterprise markets. The same products and technology can also be used to create application-specific products and solutions. Key segments that we focus on are unified communications, contact centers, SIP trunking and hosted services markets that have been adopting VoIP solutions.

- *Work close to market and customers.* Our partners and customers are distributed around the world, and part of our ability to serve them is by being close by. For this reason, we are investing in building local operations in key countries and regions, including sales, marketing and support resources to closely serve our partners and customers.
- *Develop a network of strategic partners.* We sell our products through or in cooperation with customers that can offer or certify our products as part of a full-service solution to their customers. We expect to further develop our strategic partner relationships with solution providers, system integrators and other service providers in order to increase our customer base. Our strategic partners include companies such as Microsoft, BroadSoft, Avaya, Genesys, Interactive Intelligence and Alcatel-Lucent.
- *Acquire complementary businesses and technologies.* We may pursue the acquisition of complementary businesses and technologies or the establishment of joint ventures to broaden our product offerings, enhance the features and functionality of our systems, increase our penetration in targeted markets and expand our marketing and distribution capabilities.

## Products

Our products facilitate the transmission of voice, data and fax over packet networks. We have incorporated our algorithms, technologies and systems design expertise in both our networking and technology product lines.

We typically categorize our revenues from products and services into two main business lines: network and technology. Network products consist of customer premises equipment, or CPE, gateways for the enterprise and service provider (or carrier) markets and of carrier-grade-oriented low- and mid-density media gateways for service providers and ESBCs. Complementing our media gateways and session border gateways as network products are our multi-service business routers (MSBR). IP phones, media servers, mobile VoIP solutions and value added application products. Sales of network products accounted for approximately 65% of our revenues in 2011 and approximately 62% of our revenues in 2012. Network services accounted for approximately 12% of our revenues in 2011 and approximately 18% of our revenues in 2012.

Technology products are enabling in nature and consist of our chips and boards business products. These are sold primarily to original equipment manufacturers, or OEMs, through distribution channels. Our chips and boards serve as building blocks that our customers incorporate in their products. In contrast, our networking products are used by our customers as part of a broader technological solution and are a box level product that interacts directly with other third party products. Sales of technology products accounted for approximately 22% of our products revenues in 2011 and approximately 19% of our products revenues in 2012. Technology services accounted for approximately 1% of our revenues in 2011 and 2012.

### *Networking products*

This line of products includes products that are network level products. Networking products are deployed in enterprise unified communications networks, service providers residential and access networks, trunking applications in carrier networks, and fixed-mobile convergence applications.

- Our *media* gateways enable voice, data and fax to be transmitted over Internet and other protocols, and interface with third party equipment to facilitate enhanced voice and data services. We offer analog media gateways for toll bypass, residential gateways, hosted, access and enterprise applications; and digital media gateways with various capacities for wireless, wireline, cable, enterprise, fixed mobile convergence, and unified communications;

- Enterprise session border controller (E-SBC) for service providers and enterprise connecting to SIP trunk and hosted *services* and between unified communications and IP PBX systems. Our E-SBCs provide security, interoperability, survivability and quality assurance that are required for reliable IP to IP connectivity between enterprise branch offices and main office, between enterprise and SIP trunking or cloud-based applications service providers. E-SBCs also connect between IP-PBXs and unified communication systems from different vendors, and enable remote workers connectivity into the enterprise VoIP network.
- Our multi-service business routers integrate multiple data, telephony and security services into a single device. Building on our media gateway CPE line, we have added the support of additional functions such as a LAN switch, a data router, a firewall and a session border controller, providing service providers with an integrated demarcation point and the enterprise with an all-in-one solution for its communications needs.
- Our IP phones include a family of high definition IP phones, suitable for integration with third party IP-PBX platforms *for* the enterprise IP telephony market, as well as into IP-Centrex service provider solutions.
- Our mobile VoIP clients include a family of soft clients for leading smartphones operating systems and a client *management* system, providing mobile roaming solutions for mobile and voice over IP and voice over broadband service providers.
- We offer a variety of products that are tailored for Microsoft unified communication environments. These products are based on our Mediant gateway platforms, as well as SPS (SIP phone support), and include survivable *branch* appliances (SBAs), enhanced gateways, E-SBCs, IP Phones, faxing solutions, call recording solutions (SmartTAP) and E911 solutions for Microsoft Lync.
- Our media servers enable conferencing, multi-language announcement functionality, and other applications for voice over packet networks.
- VoIP Network Assessment (VNA). We offer a professional service module of VoIP network assessment for enterprises. The VNA is provided to enterprises seeking a smooth and high quality transition to deployment of unified communications (e.g., Microsoft Lync) and IP Contact Centers. The VNA provides the customer an understanding of its current IP network capability and readiness to carry high quality VoIP traffic on top of data services.
- Value added applications for unified communications.

We support our networking products with a range of professional services. See “Business-Services” below for a description of our professional services.

#### *Technology Products*

This line of products serves as a building block for network level products. Our technology products are enabling products that are part of our own or our customers’ products.

- Our signal processor chips process and compress voice, data and fax and enable connectivity between traditional telephone networks and packet networks;



- VoIP communications boards;
- Media processing boards for enhanced services and functionalities; and
- Voice and data logging hardware integration board products.

Our products are designed to build on our core technologies and competencies extending them both vertically (chips inserted into boards, boards inserted into digital media gateways) and horizontally into different applications for different market segments, such as enterprise, call centers, wireline, cable and wireless.

#### *Our Product Families - Networking Products*

##### *Analog Media Gateways for Toll Bypass, Service Provider Access and Enterprise Applications*

Our MediaPack™ family comprises our analog and basic rate interface, or BRI, media gateways for toll bypass, service provider access and enterprise applications. These products are designed to empower the next-generation network by providing cost-effective, cutting-edge technology solutions that deliver voice and fax services to the corporate market, small businesses and home offices. Our analog media gateways for access and enterprise applications provide media streaming functionality while being either controlled by a centralized call agent or used in box VoIP control protocols (SIP, H.323, and MGCP). Convergence of data, voice and fax is achieved by a combination of the media gateway with any IP access technology, eliminating the cost of multiple access circuits. This product family utilizes our experience and digital signal processing, or DSP, technology for echo cancellation, voice compression, silence suppression and comfort noise generation. Part of this line is composed of our analog residential gateways whose primary target market is the large volume residential service providers, or SP, market.

The MediaPack™ family represents a feature rich product for streaming voice quality with a powerful analog interface supporting all major control protocols, such as H323, SIP and MGCP, and is also capable of supporting unified communication and FMC applications.

The MediaPack family also includes the MP-2xx family of residential gateways, including the MP-252 and MP-262 multimedia home gateways. The MediaPack 252 (MP-252) is a feature-rich, multimedia home gateway for broadband networks with multi-play support. With ADSL2+ modem, multiple antenna wireless LAN connectivity, DECT handsets supporting HD VoIP, bluetooth interface for connecting cellular phones and optional battery backup, it is targeting the tiers of service providers that offer multi-play home services over broadband networks. In addition to including the same features as the MP-252, the Media Pack MP-262 also supports VDSL2 and Gigabit access. The market for this product is focused on direct engagement with service providers, as this product typically requires specific integration with the network.

##### *The Mediant Family of Products - Digital and Mixed (Digital and Analog) Media Gateways, Enterprise Session Border Controllers (ESBC's) and Multi-Service Business Routers for Service Provider Access and Enterprise Applications (Mediant™ 600,800, 1000,2000,3000 Media Gateways and ESBC's and Mediant 500, 800, 850 and 1000™ MSBR's),as well as higher capacity Media and Transcoding Gateways for Wireless, Wireline and Cable Service Provider networks (Mediant, 5000, 8000)*

The Mediant™ product family offers scalability and functionality, providing a full suite of standards compliant control protocols and public switched telephone network, or PSTN, signaling interfaces for a variety of applications in most unified communications, IP-PBX, SIP application and softswitch controlled environments. This product family is compatible with popular voice over IP voice coders and protocols, including code-division multiple access, or CDMA, global system for mobile communications, or GSM, CDMA2000, universal mobile telecommunications service, or UMTS, and Long Term Evolution (LTE), as well as popular narrowband and wideband voice coders used in enterprise and Over the Top networks, such as SILK, RTA, SPEEX, G.722 and more. It builds on our VoIPerfect® architecture, which is installed in millions of lines worldwide. It is also interoperable with most of the world's leading vendors.

The Mediant<sup>TM</sup> family provides customers with a comprehensive line of different sized gateways and E-SBCs. Small or medium-sized gateways enable cost-effective solutions for enterprise or small points of presence, as well as entry into fast growing new and emerging markets. The large gateways scale to central office capacities and are designed to meet carriers' operational requirements. The Mediant family of media gateways is capable of supporting unified communication, contact center and service provider VoIP applications which may be of increased interest to enterprises and service providers.

The Mediant family of products consists of a number of models that offer different capacity, that is the number of concurrent calls or sessions that the gateway or ESBC can handle. The capacity of our Mediant products range from approximately 30 concurrent calls/sessions to 8,000 concurrent calls/sessions.

Our Mediant 1000 and Mediant 800 have three different models. The first two models are a modular VoIP media gateway and enterprise session border controllers. The other model includes multi-service business routers, or MSBRs, which are networking devices that combine multiple multiservice functions such as a media gateway, session border controller, data router, firewall, LAN switch, WAN access and survivability. The MSBR concept is designed to address the needs of service providers that offer IP-Centrex and SIP trunking services and of distributed enterprises. The range of interfaces supported on the Mediant 800 and Mediant 1000 MSBR include a variety of voice and data (WAN) interfaces.

The Mediant MSBRs include the Mediant500 and Mediant850 pure MSBR platforms and are based on AudioCodes' VoIPerfect best-of-breed media gateway technology, combined with enterprise class session border controller, data and voice security elements, data routing, LAN switching and WAN access.

Our product line specifically designed for the Microsoft unified communications environment, known as Lync, is constantly upgraded to support the latest Microsoft unified communications specifications. These products include Lync qualified IP Phones, enhanced gateways, enterprise session border controllers and survivable branch appliances based on our Mediant family, as well as SPS (SIP phone support), a software platform that enables the connectivity of third party SIP phones into the Microsoft environment, and SmartTAP, a passive compliance recording solution. The marketing and sales of these products utilizes our growing network of Microsoft VSPs (voice specialized partners) with whom we work closely.

Our ESBC technology integrates into all Mediant platforms. It offers secure VoIP and multimedia traversal of firewall, or FW, and network address translation, or NAT, systems, as well as denial of service, or DoS, attack prevention at both the signaling and media layers. These products target the VoIP security and connectivity needs of enterprises of different sizes, migrating from traditional PSTN connectivity to SIP trunking or hosted services. NAT and FW traversal are necessary to allow VoIP and multimedia sessions to pass from the service provider ("SP") network to the residential or enterprise networks. Security and DoS attack prevention protects the enterprise from fraud attacks that load an application server until it crashes.

The Mediant ESBC also provides comprehensive quality of service, or QoS, mechanisms and protocol mediation, which is the translation between two variants of the same VoIP protocol to enable two VoIP systems to communicate with each other. Examples of protocol mediation include connecting an IP PBX with SIP trunk services or connecting between two unified communication systems of different vendors. In addition, ESBCs support remote workers connectivity, enabling unified communications over IP between the enterprise and its workers located outside the premises. As the ESBC line is an evolution of our existing gateway line, the market for these products is expected to include the same evolving channel strategy, including value-added resellers and service provider channels.

The Mediant 800 and 1000 products can also include an OSN (open solutions network) server module featuring a general purpose CPU and hard disk, allowing hosting of any third-party off-the-shelf application. This solution enables system integrators and software vendors to use these platforms for integrated unified communications solutions.

#### *IPmedia™ Servers for Enhanced Services and Functionalities*

IPmedia™ platforms are designed to answer the growing market demand for enhanced voice services over packet networks, particularly network-based applications like unified communications, call recording, and conferencing by carriers and application service providers. IPmedia™ enables our customers to develop and market applications such as unified communications, interactive voice response, call-centers, conferencing and voice-activated personal assistants.

#### *300HD and 400HD Series of High Definition IP Phones*

AudioCodes 300 and 400 Series of HD VoIP-enabled IP phones offer a new dimension of voice call quality and clarity for the enterprise and service provider markets. This product line enables us to provide an end-to-end solution which relies heavily on the technological infrastructure and proven track record in providing state-of-the art high quality VoIP products for enterprise, wireline, wireless and cable applications.

The 300 and 400 Series of IP phones meet the demand for high definition VoIP solutions in end-user phones and terminals, providing high voice fidelity, advanced security and features and enhanced user interface. Our IP phones are widely interoperable with numerous IP-PBXs, soft switches and IP-Centrex solutions.

#### *VoIP Mobile Access Solution (VMAS)*

VMAS is our mobile VoIP solution comprised of a client management system (CMS) and a variety of mobile soft clients for leading iOS and Android based mobile operating systems and smartphones. The market for this product is focused on direct engagement with service providers, as this product typically requires specific integration with the service provider's network.

#### *Element Management System*

Our element management system, or EMS, is an advanced solution for centralized, standards-based management of our VoP gateways, covering all areas vital to the efficient operations, administration, management and provisioning of our Mediant™ and MediaPack™ VoP gateways and session border controllers.

Our EMS offers network equipment providers and system integrators fast setup of medium and large VoP networks with the advantage of a single centralized management system that configures, provisions and monitors all of AudioCodes gateways and session border controllers deployed, either as customer premises equipment, access or core network platforms.

#### *Session Experience Manager (SEM):*

Our Session Experience Manager, or SEM, is a software solution built to monitor, analyze, report and control the quality of incoming and outgoing enterprise voice calling over internet protocol networks in real-time. SEM is designed as an intuitive, easy to use solution, which includes an array of advanced tools producing a continuous comprehensive view of voice quality of experience at the enterprise network and its connecting trunks. Among these tools are network views to map devices and their associated voice quality, graphic illustrations of VoIP call metrics, convenient drill down details of a given call, traffic trend analysis to identify current and future bottlenecks, active and historic alarm display, and flexible pre-defined reports. In addition to VoIP, SEM includes a tool for analyzing fax transmission quality. SEM complements our Element Management System (EMS) by providing comprehensive configuration, monitoring and performance solutions for IT managers and service providers deploying a network of AudioCodes network products.

## *Our Product Families - Technology Products*

### *Voice Over Packet Processors*

Our signal processor chips compress and decompress voice, data and fax communications. This enables these communications to be sent from circuit-switched telephone networks to packet networks. Our chips are digital signal processors on which we have embedded our algorithms. These signal processor chips are the basic building blocks used by our customers and us to enable their products to transmit voice, fax and data over packet networks. These chips may be incorporated into our communications boards, media gateway modules and analog media gateways for access and enterprise applications or they may be purchased separately and incorporated into other boards or customer products.

### *TrunkPack™ VoIP Communication Boards*

Our communications boards are designed to operate in gateways connecting the circuit-switched telephone network to packet networks based on Internet protocols. Our boards comply with VoIP industry standards and allow for interoperability with other gateways. Our boards support standards-based open telecommunications architecture systems and combine our signal processor chips with communications software, signaling software and proprietary hardware architecture to provide a cost efficient interoperable solution for high capacity gateways. We believe that using open architecture permits our customers to bring their systems to market quickly and to integrate our products more easily within their systems.

### *IPmedia™ Boards for Enhanced Services and Functionalities*

The IPmedia™ product family is designed to allow OEMs and application partners to provide sophisticated content and services that create revenue streams and customer loyalty through the ability to provide additional services. The IPmedia™ boards provides voice and fax processing capabilities to enable, together with our partners, an architecture for development and deployment of enhanced services.

### *Voice and Data Logging Hardware Integration Board Products*

The SmartWORKS™ family of products is our voice and data logging hardware integration board product line. SmartWORKS™ boards for the call recording and voice/data logging industry are compatible with a multitude of private branch exchange, or PBX, telephone system integrations.

## **Services**

To support today's complex multi-service networks, AudioCodes has developed a comprehensive professional services program intended to provide responsive, preventive, and consultative support of AudioCodes networking products. AudioCodes professional services support networking devices, applications and infrastructures, allowing large organizations and service providers to realize the potential of a high-performance multi-service network. The foundation for AudioCodes professional services is a network life-cycle model based on the four basic phases of planning, design, implementation and optimizing. The result is a specially designed portfolio of complementary and synergistic service components. Services accounted for approximately 13% of our revenues in 2011 and approximately 19% of our revenues in 2012.

## Core Technologies

We believe that one of our key competitive advantages is our broad base of core technologies ranging from advanced voice compression algorithms to complex architecture system design. We have developed and continue to build on a number of key technology areas. We have named our cross platform core technology VoIPerfect. It essentially allows us to leverage the same feature set and interoperability with other products across our product lines.

### *Narrowband and Wideband (HDVoIP) Voice Compression Algorithms*

Voice compression techniques are essential for the transmission of voice over packet networks. Voice compression exploits redundancies within a voice signal to reduce the bit rate required to digitally represent the voice signal, from 64 kilobits per second, or kbps, down to low bit rates ranging from 5.3 kbps to 8 kbps, while still maintaining acceptable voice quality. A bit is a unit of data. Different voice compression algorithms, or coders, make certain tradeoffs between voice quality, bit rate, delay and complexity to satisfy various network requirements. Use of voice activity detection techniques and silence removal techniques further reduce the transmission rate by detecting the silence periods embedded in the voice flow and discarding the information packets which do not contribute to voice intelligibility.

We are one of the innovators in developing low bit rate voice compression technologies. Our patented MP-MLQTM coder was adopted in 1995 by the ITU as the basis for the G.723.1 voice coding standard for audio/visual applications over circuit-switched telephone networks. By adhering to this standard, system manufacturers guarantee the interoperability of their equipment with the equipment of other vendors.

We also provide wideband compression techniques that provide high definition VoIP quality, which expands the sampled frequency range from the traditional narrowband frequency range of 3.3Khz to over 7Khz, providing better voice quality and intelligibility, and a better user expertise. This technology is expanding and is expected to become a de-facto standard for future VoIP communications.

### *Advanced Digital Signal Processing Algorithms*

To provide a complete voice over packet communications solution, we have developed a library of digital signal processing functions designed to complement voice compression coders with additional functionality, including: echo cancellation; voice activity detection; facsimile and data modem processing; and telephony signaling processing. Our extensive experience and expertise in designing advanced digital signal processing solutions allows us to implement algorithms using minimal processing memory and power resources.

Our algorithms include:

*Echo cancellation.* Low bit rate voice compression techniques introduce considerable delay, necessitating the use of echo cancellation algorithms. The key performance criterion of an echo canceller is its ability to deal with large echo reflections, long echo delays, fast changing echo characteristics, diverse telecommunications equipment and network effects. Our technology achieves low residual echo and fast response time to render echo effects virtually unnoticeable.

*Fax transmission.* There are two widely used techniques for real time transmission of fax over networks based on Internet protocols: fax relay and fax spoofing. Fax relay takes place when a fax is sent from a fax machine through a gateway over networks based on Internet protocols in real time to a fax machine at the other end of the network. At the gateway, the analog fax signals are demodulated back into digital data, converted into packets, routed over the packet network and reassembled at the receiving end. Fax relay is used when the round trip network delay is small (typically below one second). When the round trip network delay increases, one of the fax machines may time out while waiting for a response from the other fax machine to arrive.

*Data modem technology.* We have developed data modem technologies that facilitate data relay over packet networks. Our data modem relay software algorithms support all existing data modem standards up to a bit rate of 14.4 kbps.

*Telephony signaling processing.* Various telephony signaling standards and protocols are employed to route calls over the traditional telephone network, some of which use “in-band” methods, which means that the signaling tones are sent over the telephone line just like the voice signal. As a result, in-band signaling tones may have to undergo the compression process just like the voice signal. Most low bit-rate voice coders, however, are optimized for speech signals and exhibit poor tone transfer performance. To overcome this, our processors are equipped with tone detection and tone generation algorithms. To provide seamless transparency between the traditional telephone network and packet networks for signaling, we employ various digital signal processing techniques for efficient tone processing.

#### *Voice Communications Software*

To transmit the compressed voice and fax over packet networks, voice packetization processes are required to construct and deconstruct each packet of data for transmission. The processing involves breaking up information into packets and adding address and control fields information according to the specifications of the appropriate packet network protocol. In addition, the software provides the interface with the signal processors and addresses packet delay and packet loss issues.

#### *Media Processing*

Our media processing products provide the enabling technology and platforms for developing enhanced voice service applications for legacy and next generation networks. We have developed media processing technologies such as message recording/playback, announcements, voice coding and mixing and call progress tone detection that enable our customers to develop and offer advanced revenue generating services such as conferencing, network announcements, voice mail and interactive voice response.

Our media processing technology is integrated into our enabling technology platforms like Voice over Packet processors and VoIP blades, as well as into our network platforms like the Mediant media gateways and the IPMedia media servers. The same technology is also integrated into our multi-service business gateways, enabling the use of these platforms to run third party VoIP software, offloading media processing from the host CPU.

#### *Addressing Multiple Networks and Standards Concurrently*

Convergence of wireline and wireless networks is becoming a key driver for deployment of voice over packet networks, enabling operators to use common equipment for both networks, thus lowering capital expenditures and operating expenses, while offering enriched services.

Our voice over packet products provide a cost-effective solution for these convergence needs, complying with the requirements of broadband Wireline operators using xDSL technologies, Cable operators, mobile operators, FTTx operators, Internet telephony service providers, or ITSPs, and virtual network Operators (VNOs). This includes support for relevant vocoders (wireline and wireless concurrently), interfaces and protocols.

Our products are also positioned to support the requirement of all types of enterprise customers. From SOHO, SMB all the way up to large enterprises, our products can provide integrated VoIP services and service provider access to enterprises in multiple vertical markets.

#### *Hardware Architectures for Dense Multi-Trunk Voice over Packet Systems*

Our voice over packet product offerings include high density, multi-trunk voice over packet systems for standards-based open telecommunications platforms in access equipment. Multi-trunk processing is centered around a design encompassing two key processing elements, signal processors performing voice, fax and data processing and a communications processor. Overall system performance, reliability, capacity, size, cost and power consumption are optimized, based on our hardware architecture, which supports high throughput rates for multi-trunk processing. On-board efficient network and system interfaces relieve the system controller from extensive real time data transfer and processing of data streams.

#### *Carrier Grade System Expertise*

To provide state of the art carrier grade media gateways, we have developed a wide expertise in a number of fields essential to such a product line. We have developed or integrated the various components required to implement a full digital media gateway solution that behaves as a unified entity to the external world. This required a major investment in adapting standard cPCI and MicroTCA (AMC) platforms to our needs. Such adaptation included optimizing power supply and cooling requirements, adding centralized shelf controllers, fabric switches and alarm cards to the chassis. Another aspect of the expertise we developed relates to high availability software and hardware design. High availability is a required feature in any carrier grade media gateway platform. We have also developed a sophisticated EMS to complete our offering. Our EMS enables the user to provision and monitor a number of media gateways from a centralized location.

#### **Customers**

Our customers consist of service providers and enterprises, primarily via channels (such as distributors), OEMs, network equipment providers and systems integrators. Historically, we have derived the majority of our revenues from sales to a small number of customers. The identities of our principal customers have changed and we expect that they will continue to change, from year to year. Historically, a substantial portion of our revenue has been derived from large purchases by a small number of original equipment manufacturers, or OEMs, and network equipment providers, or NEPs, systems integrators and distributors. ScanSource Communications, our largest customer, accounted for 9.8% of our revenues in 2010, 14.4% of our revenues in 2011 and 13.7% of our revenues in 2012. Our top three customers accounted for approximately 22.2% of our revenues in 2010, 25.5% of our revenues in 2011 and 25.3% of our revenues in 2012.

#### **Sales and Marketing**

Our sales and marketing strategy is to secure the leading channels and system integrators in each region, partner with leading application companies and achieve design wins with network equipment providers in our targeted markets. We select our partners based on their ability to provide effective field sales, marketing communications and technical support to our customers. In addition, we engage in direct sales and marketing with significant operators and enterprises. Prospective customers and channels generally must make a significant commitment of resources to test and evaluate our products and to integrate them into larger systems, networks and applications. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. For these reasons, the sales cycles of our products to new customers are often lengthy, averaging approximately six to twelve months after achieving a design win. This time may be further extended because of internal testing, field trials and requests for the addition or customization of features.

We also provide our customers with reference platform designs, which enable them to achieve easier and faster transitions from the initial prototype designs we use in the test trials through final production releases. We believe this significantly enhances our customers' confidence that our products will meet their market requirements and product introduction schedules.

We market our products in the United States, Europe, Asia, Latin America and Israel primarily through a direct sales force. We have invested significant resources in setting up local sales forces giving us a presence in relevant markets. We have given particular emphasis to emerging markets such as Latin America, Asia and Eastern Europe in addition to continuing to sell our products in developed countries.

We have generally entered into a combination of exclusive and non-exclusive sales representation agreements with these customers in each of the major countries in which we do business. These agreements are typically for renewable 12-month terms, are terminable at will by us upon 90 days' notice, and do not commit the customer to any minimum sales of our products to third parties. Some of our customers have the ability to return some of the products they have previously purchased and purchase more up to date models.

## **Manufacturing**

Some of our components are obtained from single suppliers. For example, Texas Instruments Incorporated supplies all of our DSP components, while Motorola and Cavium Networks provide embedded CPU and network processors. Other components are generic in nature and we believe they can be obtained from multiple suppliers.

We have not entered into any long-term supply agreements. However, we have worked for years in several countries with established global manufacturing leaders such as Flextronics and have a good experience with their level of commitment and ability to deliver. To date, we have been able to obtain sufficient amounts of these components to meet our needs and do not foresee any supply difficulty in obtaining timely delivery of any parts or components. However, an interruption in supply from any of these sources, especially with regard to DSP components from Texas Instruments Incorporated and CPU and network processors from both Cavium Networks and Motorola, or an unexpected termination of the manufacture of certain electronic components, could disrupt production, thereby adversely affecting our results. We generally maintain an inventory of critical components used in the manufacture and assembly of our products although our inventory of signal processor chips would likely not be sufficient in the event that we had to engage an alternate supplier for these components.

We utilize contract manufacturing for substantially all of our manufacturing processes. Most of our manufacturing is carried out by third-party subcontractors in Israel, China and Taiwan. Our internal manufacturing activities consist primarily of the production of prototypes, test engineering, materials purchasing and inspection, final product configuration and quality control and assurance.

In addition, we have engaged several original design manufacturers, or ODM, based in Asia to design and manufacture some of our products. We may engage additional ODMs in the future. Termination of our commercial relationship with an ODM or the discontinuance of manufacturing of products by an ODM would negatively affect our business operations.

We are obligated under certain agreements with our suppliers to purchase goods and to purchase excess inventory. Aggregate non-cancellable obligations under these agreements as of December 31, 2012 were approximately \$1.2 million.



## Industry Standards and Government Regulations

Our products must comply with industry standards relating to telecommunications equipment. Before completing sales in a country, our products must comply with local telecommunications standards, recommendations of quasi-regulatory authorities and recommendations of standards-setting committees. In addition, public carriers require that equipment connected to their networks comply with their own standards. Telecommunication-related policies and regulations are continuously reviewed by governmental and industry standards-setting organizations and are always subject to amendment or change. Although we believe that our products currently meet applicable industry and government standards, we cannot be sure that our products will comply with future standards.

We are subject to telecommunication industry regulations and requirements set by telecommunication carriers that address a wide range of areas including quality, final testing, safety, packaging and use of environmentally friendly components. We comply with the European Union's Restriction of Hazardous Substances Directive (under certain exemptions) that requires telecommunication equipment suppliers to not use some materials that are not environmentally friendly. These materials include cadmium, hexavalent chromium, lead, mercury, polybrominated biphenyls and polybrominated diphenyl ethers. Under the directive, an extension for compliance was granted with respect to the usage of lead in solders in network infrastructure equipment. We expect that other countries, including countries we operate in, will adopt similar directives or other additional regulations.

## Competition

Competition in our industry is intense and we expect competition to increase in the future. Our competitors currently sell products that provide similar benefits to those that we sell. There has been a significant amount of merger and acquisition activity and strategic alliances frequently involving major telecommunications equipment manufacturers acquiring smaller companies, and we expect that this will result in an increasing concentration of market share among these companies, many of whom are our customers.

Our principal competitors in the area of analog media gateways (2 to 24 ports) for access and enterprise are Linksys (a division of Cisco Systems, Inc.), Mediatix Telecom, Inc., Vega Stream Limited, Innovaphone AG, NET (acquired by Sonus Networks), Tainet Communication System Corp., D-Link Systems, Inc., Patton, Sangoma, Dialogic and Edgewater.

Our principal competitors in the residential gateway market are Pirelli Broadband (ADB), Technicolor (previously Thomson), Sagemcom, ZyXEL, Netgear, Bewan (Pace), Huawei, FiberHome and ZTE.

In the area of low and mid density digital gateways we face competition from companies such as Nokia-Siemens, Huawei and from Cisco, Dialogic, Genband, Sonus Networks, NET (acquired by Sonus Networks), Patton, Ferrari and Sngoma.

Our competitors in the area of multi-service business gateways are companies such as Cisco, Juniper, Adtran, One Access, Patton, Huawei, HP/3Com, Alcatel and more.

Specifically in the enterprise class session border controller technology we compete with ACME Packet (acquired by Oracle), Cisco, SIPera (acquired by Avaya), Sonus Networks, NET (acquired by Sonus Networks), Ingate and Edgewater.

Our competitors in the Microsoft Lync certified gateway and session border controller markets include NET (acquired by Sonus Networks), Sonus, Dialogic, Cisco, Ferrari, HP, Ingate and ACME Packet (acquired by Oracle).

Some of our competitors are also customers of our products and technologies.

Our principal competitors in the sale of signal processing chips are Broadcom, Octasic and Mindspeed. Other indirect competition is arriving from the integration of VoIP functionality into processors (running the VoIP signal processing on generic ARM/MIPS cores), thus decreasing the need for dedicated signal processing chips in a VoIP product. Examples to such manufacturers are Cavium, Texas Instruments and more. Our principal competitors in the communications board market are Dialogic, Sangoma and PIKA Technologies.

Our principal competitors in the area of IP phones are comprised of “best-of-breed” IP phone vendors and end-to-end IP telephony vendors. “Best-of-breed” IP phone vendors sell standard-based SIP phones that can be integrated into any standards-based IP-PBX or hosted IP telephony systems. These competitors include Polycom, HP, Yalink and SNOM. End-to-end IP telephony vendors sell IP phones that only work in their proprietary systems. These competitors include Cisco, Avaya, Alcatel-Lucent, Siemens, Aastra, NEC and more.

Many of our competitors have the ability to offer vendor-sponsored financing programs to prospective customers. Some of our competitors with broad product portfolios may also be able to offer lower prices on products that compete with ours because of their ability to recoup a loss of margin through sales of other products or services. Additionally, voice, audio and other communications alternatives that compete with our products are being continually introduced.

In the future, we may also develop and introduce other products with new or additional telecommunications capabilities or services. As a result, we may compete directly with VoIP companies and other telecommunications infrastructure and solution providers, some of which may be our current customers. Additional competitors may include companies that currently provide communication software products and services. The ability of some of our competitors to bundle other enhanced services or complete solutions with VoIP products could give these competitors an advantage over us.

### **Intellectual Property and Proprietary Rights**

Our success is dependent in part upon proprietary technology. We rely primarily on a combination of patent, copyright and trade secret laws, as well as confidentiality procedures and contractual provisions, to protect our proprietary rights. We also rely on trademark protection concerning various names and marks that serve to identify it and our products. While our ability to compete may be affected by our ability to protect our intellectual property, we believe that because of the rapid pace of technological change in our industry maintaining our technological leadership and our comprehensive familiarity with all aspects of the technology contained in our signal processors and communication boards is also of primary importance.

We own U.S. patents that relate to our voice compression and session border control technologies. We also actively pursue patent protection in selected other countries of interest to us. In addition to patent protection, we seek to protect our proprietary rights through copyright protection and through restrictions on access to our trade secrets and other proprietary information which we impose through confidentiality agreements with our customers, suppliers, employees and consultants.

There are a number of companies besides us who hold or may acquire patents for various aspects of the technology incorporated in the ITU’s standards or other industry standards or proprietary standards, for example, in the fields of wireless and cable. While we have obtained cross-licenses from some of the holders of these other patents, we have not obtained a license from all of the holders. The holders of these other patents from whom we have not obtained licenses may take the position that we are required to obtain a license from them. Companies that have submitted their technology to the ITU (and generally other industry standards making bodies) for adoption as an industry standard are required by the ITU to undertake to agree to provide licenses to that technology on reasonable terms. Accordingly, we believe that even if we were required to negotiate a license for the use of such technology, we would be able to do so at an acceptable price. Similarly, however, third parties who also participate with respect to the same standards-setting organizations as do we may be able to negotiate a license for use of our proprietary technology at a price acceptable to them, but which may be lower than the price we would otherwise prefer to demand.

Under a pooling agreement dated March 3, 1995, as amended, between AudioCodes and DSP Group, Inc., on the one hand, and France Telecom, Université de Sherbrooke and their agent, Sipro Lab Telecom, on the other hand, we and DSP Group, Inc. granted to France Telecom and Université de Sherbrooke the right to use certain of our specified patents, and any other of our and DSP Group, Inc. intellectual property rights incorporated in the ITU G.723.1 standard. Likewise France Telecom and Université de Sherbrooke granted AudioCodes and DSP Group, Inc. the right to use certain of their patents and any other intellectual property rights incorporated in the G.723.1 standard. In each case, the rights granted are to design, make and use products developed or manufactured for joint contribution to the G.723.1 standard without any payment by any party to the other parties.

In addition, each of the parties to the agreement granted to the other parties the right to license to third parties the patents of any party included in the intellectual property required to meet the G.723.1 standard, in accordance with each licensing party's standard patent licensing agreement. The agreement provides for the fee structure for licensing to third parties. The agreement provides that certain technical information be shared among the parties, and each of the groups agreed not to assert any patent rights against the other with respect of the authorized use of voice compression products based upon the technical information transferred. Licensing by any of the parties of the parties' intellectual property incorporated in the G.723.1 standard to third parties is subject to royalties that are specified under the agreement.

Each of the parties to the agreement is free to develop and sell products embodying the intellectual property incorporated into the G.723.1 standard without payment of royalties to other parties, so long as the G.723.1 standard is implemented as is, without modification. The agreement expires upon the last expiration date of any of the AudioCodes, DSP Group, Inc., France Telecom or Université de Sherbrooke patents incorporated in the G.723.1 standard. The parties to the agreement are not the only claimants to technology underlying the G.723.1 standard.

We are aware of parties who may be infringing our technology that is part of the G.723.1 standard. We evaluate these matters on a case by case basis, directly or through our licensing partner. Although we have not yet determined whether to pursue legal action, we may do so in the future. There can be no assurance that any legal action will be successful.

Third parties have claimed, and from time to time in the future may claim, that our past, current or future products infringe their intellectual property rights. Intellectual property litigation is complex and there can be no assurance of a favorable outcome of any litigation. Any future intellectual property litigation, regardless of outcome, could result in substantial expense to us and significant diversion of the efforts of our technical and management personnel. Litigation could also disrupt or otherwise severely impact our relationships with current and potential customers as well as our manufacturing, distribution and sales operations in countries where relevant third party rights are held and where we may be subject to jurisdiction. An adverse determination in any proceeding could subject us to significant liabilities to third parties, require disputed rights to be licensed from such parties, assuming licenses to such rights could be obtained, or require us to cease using such technology and expend significant resources to develop non-infringing technology. We may not be able to obtain a license at an acceptable price.

We have entered into technology licensing fee agreements with third parties. Under these agreements, we agreed to pay the third parties royalties, based on sales of relevant products.

## Legal Proceedings

We are not a party to any material legal proceedings, except for the proceedings referred to below.

In May 2007, we entered into an agreement with respect to property adjacent to our headquarters in Israel, pursuant to which a building of approximately 145,000 square feet was erected and was expected to be leased to us for a period of eleven years. This new building was substantially completed on a structural level in May 2010. The landlord claimed that we should have taken delivery of the building at that time and started paying rent. We disagreed with the landlord's interpretation of the relevant agreement. As a result, the landlord terminated the agreement and leased the property to a third party. This dispute has been referred to arbitration where we claim that due to the landlord's failure we lost significant potential revenues due. The landlord counterclaimed alleging that it sustained losses equal to approximately one year's rent and management fees in the aggregate amount of approximately NIS 14 million (approximately \$3.75 million based on the December 31, 2012 exchange rate). We believe that we have valid defenses to the counterclaim and a provision is not required.

On January 14, 2009, Nortel Networks, Inc. and certain of its affiliates filed petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). On May 27, 2011, Nortel commenced an action against AudioCodes Inc. and AudioCodes Ltd. (collectively, "AudioCodes") in the United States Bankruptcy Court for the District of Delaware. Nortel asserted that AudioCodes received approximately \$3,153,000 in payments from Nortel in the 90-day period prior to Nortel's bankruptcy filing. Nortel asserted that these payments constituted avoidable preferential transfers pursuant to 11 U.S.C. 547(b) of the Bankruptcy Code and Nortel was entitled to recover these payments from AudioCodes pursuant to 11 U.S.C. § 550. The parties have settled the matter pursuant to the *Stipulation of Settlement of Avoidance Claims and Recoupment of Claims by and Between the Debtors, AudioCodes, Inc. and AudioCodes, Ltd.* (the "Stipulation"). Under the Stipulation, AudioCodes paid \$20,000 to Nortel and all claims by the parties have been released and withdrawn. On July 10, 2012, the Court entered an order approving the Stipulation and the adversary proceeding was closed on August 1, 2012.

On September 15, 2011, a patent infringement action was commenced by CyberFone Systems, LLC, formerly known as LVL Patent Group LLC, in the United States District Court for the District of Delaware against our subsidiary, AudioCodes Inc. and numerous other defendants, alleging that AudioCodes Inc. and the other defendants infringed plaintiff's intellectual property rights in five patents. The claims made in this action are being defended by AudioCodes Inc. The Court granted defendants' motion for summary judgment of invalidity on U.S. Patent No. 8,019,060, dismissing all claims of infringement based on this patent. Plaintiff continues to maintain its action against AudioCodes Inc. and certain other defendants based on alleged infringement of four other patents that were not dismissed from the action. Preliminary discovery has begun, but it is not possible to predict the outcome of this proceeding. We believe we have valid defenses to plaintiff's claims and a provision is not required.

On November 1, 2011, a patent infringement action was commenced by Klausner Technologies, Inc. in the United States District Court for the Eastern District of Texas against AudioCodes Inc. alleging that AudioCodes Inc. infringed the plaintiff's intellectual property rights in one patent. All claims asserted in the action by Klausner Technologies against AudioCodes Inc. were dismissed without prejudice by the court on May 15, 2012.

In January 2013, one of our former senior executives sent a letter of demand claiming an amount of approximately \$1 million dollars relating to his termination of employment. We have denied all of his allegations and we believe that we have valid defenses to this claim.

In February 2013, a patent infringement action was commenced by AIM IP, LLC in the United States District Court of Central District of California Southern Division against our subsidiary, AudioCodes Inc. and other defendants alleging that AudioCodes Inc. infringed the plaintiff's intellectual property rights in one patent. One of the other defendants is a customer of ours that has informed us that it believes it is entitled to indemnification from us with respect to this litigation. The proceeding is at an early stage and it is not possible at this time to predict the outcome of these proceedings. We believe that we have valid defenses to the claims.

**C. ORGANIZATIONAL STRUCTURE**

**List of Significant Subsidiaries**

AudioCodes Inc., our wholly-owned subsidiary, is a Delaware corporation.

**D. PROPERTY, PLANTS AND EQUIPMENT**

We lease our main facilities, located in Airport City, Lod, Israel, which occupy approximately 200,000 square feet for annual lease payments of approximately \$4.7 million (including management fees). In addition, we entered into an agreement with Airport City, Ltd. regarding the neighboring property pursuant to which a building of approximately 145,000 square feet was erected and was to be leased to us for period of eleven years. We are currently engaged in a dispute with the landlord. See Item 4B—"Information on the Company-Business Overview-Legal Proceedings."

Our U.S. subsidiary, AudioCodes Inc., leases approximately 28,000 square foot facility in Somerset, New Jersey. AudioCodes Inc. also leases offices in Plano, Texas, San Jose, California, Raleigh, North Carolina, Boston, Massachusetts. The annual lease payments (including management fees) for all our offices in the United States are approximately \$700,000.

We believe that these properties are sufficient to meet our current needs. However, we may need to increase the size of our current facilities, seek new facilities, close certain facilities or sublease portions of our existing facilities in order to address our needs in the future.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

**Critical Accounting Policies and Estimates**

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

On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition and allowance for sales returns, allowance for doubtful accounts, inventories, intangible assets, goodwill, income taxes and valuation allowance, stock-based compensation and contingent liabilities. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Our management has reviewed these critical accounting policies and related disclosures with our Audit Committee. See Note 2 to our Consolidated Financial Statements, which contain additional information regarding our accounting policies and other disclosures required by US GAAP.

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

- Revenue recognition and allowance for sales returns;
- Allowance for doubtful accounts;
- Inventories;
- Intangible assets;
- Goodwill;
- Income taxes and valuation allowance;
- Stock-based compensation; and
- Contingent liabilities.

#### *Revenue Recognition and Allowance for Sales Returns*

We generate our revenues primarily from the sale of products. We sell our products through a direct sales force and sales representatives. Our customers include original equipment manufacturers, network equipment providers, systems integrators and distributors in the telecommunications and networking industries, all of whom are considered end-users.

Revenues from products are recognized in accordance with Staff Accounting Bulletin ("SAB") 104, Revenue Recognition in Financial Statements when the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery of the product has occurred, (iii) the fee is fixed or determinable and (iv) collectability is probable. We have no obligation to customers after the date on which products are delivered, other than pursuant to warranty obligations and any applicable right of return. We grant to some of our customers the right of return or the ability to exchange a specific percentage of the total price paid for products they have purchased over a limited period for other products.

We maintain a provision for product returns and exchanges and other incentives. This provision is based on historical sales returns, analysis of credit memo data and other known factors. This provision amounted to \$1.4 million in 2010, \$823,000 in 2011 and \$1.2 million in 2012.

Revenues from the sale of products which were not yet determined to be final sales due to market acceptance or technological compatibility were deferred and included in deferred revenues. In cases where collectability is not probable, revenues are deferred and recognized upon collection. Revenues from services are recognized ratably over the time of the service agreement, usually one year.

In 2011, we adopted, on a prospective basis, the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2009-13, Topic 605 - Multiple-Deliverable Revenue Arrangements ("ASU 2009-13"). ASU 2009-13 changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of consideration to each deliverable to be based on the relative selling price.

The selling price for a deliverable is based on its vendor-specific objective evidence (“VSOE”) if available, third-party evidence (“TPE”) if VSOE is not available, or estimated selling price (“ESP”) if neither VSOE nor TPE is available. We then recognize revenue on each deliverable in accordance with our policies for product and service revenue recognition. VSOE of selling price is based on the price charged when the element is sold separately. In determining VSOE, we require that a substantial majority of the selling prices fall within a narrow range based on stand alone rates. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as our products contain a significant element of proprietary technology and our solutions offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as we are unable to reliably determine the selling prices of competitors products on a stand-alone basis, we are not typically able to determine TPE. The ESP is established considering multiple factors including, but not limited to, pricing practices in different geographical areas and through different sales channels, gross margin objectives, internal costs, the pricing strategies of our competitors, and industry technology lifecycles. The selling price of the products and professional services was based on ESP. Maintenance selling price was based on VSOE.

We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or subject to customer-specific return or refund privileges. We evaluate each deliverable in an arrangement to determine whether it represents a separate unit of accounting.

ASU 2009-13 did not have a significant impact on our net revenues for the years ended December 31, 2011 and 2012, compared to the net revenues that would have been recorded under the previous accounting rules.

Prior to 2011, we allocated revenue to each element using the residual method when the VSOE of fair value of the undelivered items for arrangements with multiple elements, such as sales of products that include services and software, exist. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. If VSOE of one or more undelivered items did not exist, revenue from the entire arrangement was deferred and recognized at the earlier of: (i) delivery of those elements or (ii) when fair value could be established unless maintenance was the only undelivered element, in which case, the entire arrangement fee was recognized ratably over the contractual support period.

#### *Allowance for Doubtful Accounts*

Our trade receivables are derived from sales to customers located primarily in the Americas, the Far East, Israel and Europe. We perform ongoing credit evaluations of our customers and to date have not experienced any material losses from uncollected receivables. An allowance for doubtful accounts is determined with respect to those amounts that we have recognized as revenue and determined to be doubtful of collection. We usually do not require collateral on trade receivables because most of our sales are to large and well-established companies. On occasion we may purchase credit insurance to cover credit exposure for a portion of our sales and this may mitigate the amount we need to write off as a result of doubtful collections.

#### *Inventories*

Inventories are stated at the lower of cost or market value. Cost is determined using the “weighted average cost” method for raw materials and on the basis of direct manufacturing costs for finished products. We periodically evaluate the quantities on hand relative to current and historical selling prices and historical and projected sales volume and technological obsolescence. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow moving items, technological obsolescence, excess inventories, discontinued products and for market prices lower than cost. We wrote-off inventory in a total amount of \$1.1 million in 2010, \$644,000 in 2011 and \$2.3 million in 2012.

### *Intangible assets*

As a result of our acquisitions, our balance sheet included acquired intangible assets, in the aggregate amount of approximately \$5.3 million as of December 31, 2010, \$4.0 million as of December 31, 2011 and \$2.9 million as of December 31, 2012.

We allocated the purchase price of the companies we have acquired to the tangible and intangible assets acquired and liabilities assumed, based on their estimated fair values. These valuations require management to make significant estimations and assumptions, especially with respect to intangible assets. Critical estimates in valuing intangible assets include future expected cash flows from technology acquired, trade names, backlog and customer relationships. In addition, other factors considered are the brand awareness and market position of the products sold by the acquired companies and assumptions about the period of time the brand will continue to be used in the combined company's product portfolio. Management's estimates of fair value are based on assumptions believed to be reasonable, but which are inherently uncertain and unpredictable.

If we did not appropriately allocate these components or we incorrectly estimate the useful lives of these components, our computation of amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect our net income.

Intangible assets are reviewed for impairment in accordance with Accounting Standards Codification (ASC) 360-10-35, "Property, Plant, and Equipment - Subsequent Measurement," 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 such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The loss is allocated to the intangible assets on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual intangible asset shall not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable.

Our intangible assets are comprised of acquired technology, customer relations, trade names, existing contracts for maintenance and backlog. All intangible assets are amortized using the straight-line method over their estimated useful life.

During 2010, 2011 and 2012 no impairment charges were identified.

### *Goodwill*

As a result of our acquisitions, our balance sheet included acquired goodwill in the aggregate amount of approximately \$32.1 million as of December 31, 2010, 2011 and 2012. Goodwill represents the excess of the purchase price and related costs over the value assigned to net tangible and identifiable intangible assets of businesses acquired and accounted for under the purchase method. In accordance with ASC 350, "Intangible, Goodwill and Other" goodwill is not amortized and is tested for impairment at least annually. Our annual impairment test is performed at the end of the fourth quarter each year. If events or indicators of impairment occur between the annual impairment tests, we perform an impairment test of goodwill at that date.

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



In September 2011, the FASB issued guidance which provides the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. We adopted the guidance, but we were not required to use it.

In July 2012, the FASB issued Accounting Standard Update 2012-02, "Intangibles - Goodwill and Other (Topic 350): Testing Indefinite Intangible Assets for Impairment," which amended the guidance in ASC 350-30 on testing indefinite-lived intangible assets, other than goodwill, for impairment allowing an entity to perform a qualitative impairment assessment. If it is determined that it is not more likely than not that the fair value of the reporting unit is less than the carrying amount, further testing of indefinite-lived intangible assets for impairment is not required and there is no need to calculate the fair value of the asset and perform a quantitative impairment test. In addition, the standard did not amend the requirement to test these assets for impairment between annual tests if there is a change in events or circumstances; however, it revised the examples of events and circumstances that should be considered in interim periods, which are identical to those assessed in the annual qualitative assessment described above. ASU 2012-02 was effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption being permitted. We adopted the guidance, but we were not required to use it.

Fair value is generally determined using discounted cash flows, market multiples and market capitalization. The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. Significant estimates used in the fair value methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples of the reportable unit. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our goodwill and intangible assets with an indefinite life.

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

#### *Income Taxes and Valuation Allowance*

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax expense in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax exposure, which is accrued as taxes payable, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets, which are included within our consolidated balance sheet. We may record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized.

Although we believe that our estimates are reasonable, there is no assurance that the final tax outcome and the valuation allowance will not be different than those which are reflected in our historical income tax provisions and accruals.

We have filed or are in the process of filing U.S. federal, state and foreign tax returns that might be subject to audit by the respective tax authorities. Although the ultimate outcome is unknown, we believe that adequate amounts have been provided for and any adjustments that may result from tax return audits are not likely to materially adversely affect our consolidated results of operations, financial condition or cash flows.

### *Stock-based compensation*

We account for stock-based compensation in accordance with ASC 718 “Compensation-Stock Compensation.” We utilize the Black-Scholes option pricing model to estimate the fair value of stock-based compensation at the date of grant. The Black-Scholes model requires subjective assumptions regarding dividend yields, expected volatility, expected life of options and risk-free interest rates. These assumptions reflect management’s best estimates. Changes in these inputs and assumptions can materially affect the estimate of fair value and the amount of our stock-based compensation expenses. We recognized stock-based compensation expense of \$2.1 million in 2010, \$2.3 million 2011 and \$1.5 million 2012. As of December 31, 2012, there was approximately \$2.1 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements granted by us. As of December 31, 2012, that expense is expected to be recognized over a weighted-average period of 1.08 years.

### *Contingent liabilities*

We are, from time to time, involved in claims, lawsuits, government investigations, and other proceedings arising from the ordinary course of our business. We record a provision for a liability when we believe that it is both probable that a liability has been incurred, and the amount can be reasonably estimated. Significant judgment is required to determine both probability and the estimated amount. Such legal proceedings are inherently unpredictable and subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions change or prove to have been incorrect, it could have a material impact on our results of operations, financial position and cash flows. See Item 4B-“Information on the Company-Business Overview-Legal Proceedings” for a discussion of claims against us by a landlord and by owners of intellectual property involving potential contingent liabilities.

## **A. OPERATING RESULTS**

You should read this discussion with the consolidated financial statements and other financial information included in this Annual Report.

### **Overview**

We design, develop and sell advanced voice over IP, or VoIP, and converged VoIP and data networking products and applications to service providers and enterprises. We are a VoIP technology leader focused on VoIP communications, applications and networking elements, and its products are deployed globally in broadband, mobile, cable, and enterprise networks. We provide a range of innovative, cost-effective products including media gateways, multi-service business gateways, residential gateways, IP phones, media servers, session border controllers, and value-added applications. Our underlying technology, VoIPerfectHD, relies primarily on our leadership in digital signal processing, or DSP, voice coding and voice processing technologies. Our high definition (HD) VoIP technologies and products provide enhanced intelligibility, and a better end user communication experience in emerging voice networks.

Our products enable our customers to build high-quality packet networking equipment and network solutions and provide the building blocks to connect traditional telephone networks to VoIP networks, as well as connecting and securing multimedia communication between different packet-based networks. Our products are sold primarily to leading original equipment manufacturers, or OEMs, system integrators and network equipment providers in the telecommunications and networking industries. We have continued to broaden our offerings, both from internal and external development and through acquisitions, as we have expanded in the last few years from selling chips to boards, subsystems, media gateway systems, media servers, session border controllers and messaging platforms. We have also increased our product portfolio to enhance our position in the market and serve our channels better as a one stop shop for voice over IP hardware.

AudioCodes offers a comprehensive professional services program intended to provide responsive, preventive, and consultative support of AudioCodes networking products. AudioCodes professional services support networking devices, applications and infrastructures, allowing large organizations and service providers to realize the potential of a high-performance multi-service network.

Our headquarters and research and development facilities are located in Israel with research and development extensions in the U.S. and U.K. We have other offices located in Europe, the Far East, and Latin America.

The identities of our principal customers have changed and we expect that they will continue to change, from year to year. Historically, a substantial portion of our revenue has been derived from large purchases by a limited number of original equipment manufacturers, or OEMs, and network equipment providers, or NEPs, systems integrators and distributors. ScanSource Communications, our largest customer, accounted for 9.8% of our revenues in 2010, 14.4% of our revenues in 2011 and 13.7% of our revenues in 2012. Our top five customers accounted for 28.6% of our revenues in 2010, 33.4% of our revenues in 2011 and 31.4% of our revenues in 2012. If we lose a large customer and fail to add new customers to replace lost revenue, our operating results may be materially adversely affected.

Revenues based on the location of our customers for the last three fiscal years are as follows:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Americas	47.7%	55.0%	52.1%
Far East	17.8	14.1%	13.7%
Europe	21.7	23.3%	28.1%
Israel	12.8	7.6%	6.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

We believe that prospective customers generally are required to make a significant commitment of resources to test and evaluate our products and to integrate them into their larger systems. Our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. For these reasons, the sales cycles of our products to new customers are often lengthy, averaging approximately six to twelve months. As a result, we may incur significant selling and product development expenses prior to generating revenues from sales.

The currency of the primary economic environment in which our operations are conducted is the U.S. dollar and, as such, we use the U.S. dollar as our functional currency. Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. All transaction gains and losses from the remeasurement of monetary balance sheet items denominated in non-U.S. dollar currencies are reflected in the statement of operations as financial income or expenses, as appropriate.

In July 2012, we announced a restructuring plan to better align our resources and assets to our core networking business. We also conducted a review of our operations to reduce annual operating expenses, simplify our organization and refine future investments.

The demand for Voice over IP, or VoIP, technology has increased during recent years. In recent years, the shift from traditional circuit-switched networks to next generation packet-switched networks continued to gain momentum. As data traffic becomes the dominant factor in communications, service providers are building and maintaining converged networks for integrated voice and data services. In developed countries, traditional and alternative service providers adopt bundled triple play (voice, video and data) and quadruple play (voice, video, data and mobile) offerings. This trend, enabled by voice and multimedia over IP, has fueled competition among cable, wireline, ISP and mobile operators, increasing the pressure for adopting and deploying VoIP networks. In addition, underdeveloped markets without basic wire line service in countries such as China and India and certain countries in Eastern Europe are adopting the use of VoIP technology to deliver voice and data services that were previously unavailable.

The general economic uncertainty, including disruptions in the world credit and equity markets, has had and continues to have a negative impact on business around the world. This economic environment has had an adverse impact on the technology industry and our major customers. Conditions may continue to be uncertain or may be subject to deterioration which could lead to a reduction in consumer and customer spending overall, which could have an adverse impact on sales of our products. A disruption in the ability of our significant customers to access liquidity could cause serious disruptions or an overall deterioration of their businesses which could lead to a significant reduction in their orders of our products and the inability or failure on their part to meet their payment obligations to us, any of which could have a material adverse effect on our results of operations and liquidity. In addition, any disruption in the ability of customers to access liquidity could lead customers to request longer payment terms from us or long-term financing of their purchases from us. Granting extended payment terms or a significant adverse change in a customer's financial and/or credit position could also require us to assume greater credit risk relating to that customer's receivables or could limit our ability to collect receivables related to purchases by that customer. As a result, our reserves for doubtful accounts and write-offs of accounts receivable could increase.

## **Results of Operations**

The following table sets forth the percentage relationships of certain items from our consolidated statements of operations, as a percentage of total revenues for the periods indicated:

Statement of Operations Data:	Year Ended December 31,		
	2010	2011	2012
<b>Revenues:</b>			
Products	88.4%	87.1%	81.3%
Services	11.6%	12.9%	18.7%
Total revenues	100.0%	100.0%	100.0%
<b>Cost of revenues:</b>			
Products	41.4	28.5	38.0
Services	2.7	2.7	4.6
Total cost of revenues	44.1	41.2	42.6
Gross profit	55.9	58.8	57.4
<b>Operating expenses:</b>			
Research and development, net	20.1	20.6	22.5
Selling and marketing	23.3	27.8	31.4
General and administrative	5.5	5.8	6.4
Total operating expenses	48.9	54.2	60.3
Operating income (loss)	6.9	4.6	(2.9)
Financial income (expenses), net	0.0	0.3	0.4
Income (loss) before taxes on income	6.9	4.9	(2.5)
Income tax benefit (expense), net	1.3	(0.1)	(0.4)
Equity in losses of affiliated companies, net	(0.1)	(0.2)	(0.3)
Net income (loss)	8.1%	4.6%	(3.2)%

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

*Revenues.* Revenues decreased 18.2% to \$127.5 million in 2012 from \$155.8 million in 2011. The decrease in revenues was due to a decrease in revenue from products.

Our revenues from products in 2012 decreased by 24% to \$103.7 million, or approximately 81% of total revenues, from \$135.8 million, or 87% of total revenues, in 2011. The decrease in revenues from products was the result of a weakness in sales in North America primarily as a result of a decline in OEM business and lower than anticipated government sales.

Our revenues from services in 2012 increased by 19% to \$23.8 million, or approximately 19% of total revenues, from \$20.0 million, or 13% of total revenues, in 2011. The increase in revenues from services was the result of an increase in our delivery of support services and professional services, mainly in North America.

*Gross Profit.* Cost of revenues includes the cost of hardware, quality assurance, overhead related to manufacturing activity, technology licensing fees payable to third parties and rent. Gross profit decreased to \$73.2 million in 2012 from \$91.7 million in 2011. Gross profit as a percentage of revenues decreased to 57.4% in 2012 from 58.8% in 2011. The decrease in our gross profit percentage was primarily attributable to the decrease in revenues because the decrease in indirect operating expenses was insignificant compared to the decrease in revenues.

Cost of revenues from services increased by \$1.7 million, or 40%, to \$5.9 million in 2012 from \$4.2 million in 2011. This increase is primarily attributable to higher support personnel expenses associated with providing services and implementations of our products with service providers as well as enterprise customers. In 2012, services gross margin decreased to 75% from 79% in 2011.

*Research and Development Expenses, net.* Research and development expenses, net, consist primarily of compensation and related costs of employees engaged in ongoing research and development activities, development-related raw materials and the cost of subcontractors less grants from the OCS and rent. Research and development expenses were \$28.7 million in 2012 and \$32.2 million in 2011. As a percentage of revenues, these expenses were 22.5% in 2012 and 20.6% in 2011. Research and development expenses decreased primarily as a result of our cost reduction plan implemented during 2012 that reduced the number of our research and development personnel. We expect that research and development expenses will be lower in 2013 than in 2012 on an absolute dollar basis as a result of our cost reduction plan.

*Selling and Marketing Expenses.* Selling and marketing expenses consist primarily of compensation for selling and marketing personnel, as well as exhibition, travel and related expenses. Selling and marketing expenses decreased 7.4% in 2012 to \$40.0 million from \$43.2 million in 2011 primarily due to a decrease in the number of employees and due to decrease in expenses related to stock-based compensation to employees. As a percentage of revenues, these expenses increased to 31.4% in 2012 from 27.8% in 2011. These expenses decreased on an absolute basis primarily as a result of our cost reduction plan implemented during 2012. We expect that selling and marketing expenses will be lower in 2013 than in 2012 on an absolute dollar basis as a result of our cost reduction plan.

*General and Administrative Expenses.* General and administrative expenses consist primarily of compensation for finance, human resources, general management, rent, network and bad debt reserve, as well as insurance and consultant services expenses. General and administrative expenses decreased 9.0% to \$8.2 million in 2012 from \$9.0 million in 2011. The decrease was primarily due to a decrease in payroll related expenses and expenses related to stock-based compensation to employees. As a percentage of revenues, general and administrative expenses increased to 6.4% in 2012 from 5.8% in 2011. We expect that general and administrative expenses will be about the same in 2013 as in 2012 on an absolute dollar basis.

*Financial Income, Net.* Financial income, net consist primarily of interest earned on cash and cash equivalents, marketable securities and bank deposits, net of interest accrued in connection with our bank loans and bank charges, as well as on our remaining senior convertible notes outstanding. Financial income, net, in 2012 was \$453,000 compared to financial income, net of \$423,000 in 2011. The increase in financial income, net in 2012 was primarily due to fluctuations in the NIS/U.S. dollar exchange rate which were partially offset by interest expenses on bank loans.

*Taxes on Income.* We had net income tax expenses of \$541,000 in 2012 compared to \$238,000 in 2011. The increase in net income tax expenses was due to taxes paid with respect to a transfer of funds from our U.S. subsidiary which was considered a dividend distribution by the U.S. Internal Revenue Service.

*Equity in Losses of Affiliated Company, Net.* Equity in losses of affiliated company, net was \$354,000 in 2012 compared to \$277,000 in 2011. The increase in this amount is attributable to an increase in losses of our affiliated company.

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

*Revenues.* Revenues increased 3.9% to \$155.8 million in 2011 from \$150.0 million in 2010. The increase in revenues was primarily due to the increased demand for networking products and services. The demand for networking products and services increased primarily due to the penetration of VoIP services in the enterprise market, including for unified communication solutions and contact centers. The increase in networking revenues was offset, in part, by a decline in revenues from technology products primarily due to a shift in emphasis in the VoIP industry from the use of technology products to installation of diverse integrated comprehensive solutions.

Our revenues from services in 2011 increased by 15% to \$20.0 million, or approximately 13% of total revenues, from \$17.4 million, or 11.6% of total revenues, in 2010. The increase in revenues from services was the result of an increase in our delivery of support services and professional services mainly in Europe and North America.

*Gross Profit.* Cost of revenues includes the manufacturing cost of hardware, quality assurance, overhead related to manufacturing activity and technology licensing fees payable to third parties. Gross profit increased to \$91.7 million in 2011 from \$83.9 million in 2010. Gross profit as a percentage of revenues increased to 58.8% in 2011 from 55.9% in 2010. The increase in our gross profit percentage was primarily attributable to an increase in our revenues from the sale of networking services, which have a significantly higher average gross margin than revenues from the sale of products. In addition, our gross profit percentage benefited from our fixed overhead costs being spread over increased revenues.

Cost of revenues from services increased by \$245,000, or 6%, to \$4.2 million in 2011 from \$4.0 million in 2010. In 2011 services gross margin increased to 79% from 77% in 2010.

*Research and Development Expenses, net.* Research and development expenses, net, consist primarily of compensation and related costs of employees engaged in ongoing research and development activities, development-related raw materials and the cost of subcontractors less grants from the OCS. Research and development expenses were \$32.2 million in 2011 and \$30.2 million in 2010. As a percentage of revenues, these expenses were 20.6% in 2011 and 20.1% in 2010. Research and development expenses increased primarily because grants from the OCS, which reduce these expenses, decreased by \$1.4 million in 2011 compared to 2010 and stock-based compensation expense included in these expenses increased to \$526,000 in 2011 from \$354,000 in 2010 predominantly due to additional stock options granted to research and development personnel.

*Selling and Marketing Expenses.* Selling and marketing expenses consist primarily of compensation for selling and marketing personnel, as well as exhibition, travel and related expenses. Selling and marketing expenses increased 23.4% in 2011 to \$43.2 million from \$35.0 million in 2010. As a percentage of revenues, these expenses increased to 27.8% in 2011 from 23.3% in 2010. These expenses increased on an absolute basis and as a percentage of revenues primarily due to an increase in selling and marketing personnel and associated expenses as a result of an increase in our sales force and support personnel in an attempt to increase our market share in the areas in which we sell our products and services.

*General and Administrative Expenses.* General and administrative expenses consist primarily of compensation for finance, human resources, general management, rent, network and bad debt reserve, as well as insurance and professional services expenses. General and administrative expenses increased 9.4% to \$9.0 million in 2011 from \$8.3 million in 2010. As a percentage of revenues, general and administrative expenses increased to 5.8% in 2011 from 5.5% in 2010. The increase in general and administrative expenses, both on an absolute and a percentage basis, was due primarily to an increase in general and administrative personnel and associated expenses and due to an increase in the allowance for doubtful accounts. Our doubtful accounts increased primarily due to a customer that did not make payment to us.

*Financial Expenses, Net.* Financial expenses, net consist primarily of interest derived on cash and cash equivalents, marketable securities and bank deposits, net of interest accrued in connection with our bank loans and bank charges, as well as on our remaining senior convertible notes outstanding. Financial income, net, in 2011 was \$423,000 compared to financial expenses, net of \$94,000 in 2010. The increase in financial income, net in 2011 was primarily due to our investment in marketable securities.

*Taxes on Income.* We had net income tax expenses of \$238,000 in 2011 compared to a net income tax benefit of \$1.9 million in 2010. The change in net income tax expenses is due to a decrease in net income tax benefit in 2011 to \$652,000 from \$2.3 million in 2010 as a result of a decrease in the available net carry forward tax losses based on our expectation of generating taxable income in the foreseeable future.

*Equity in Losses of Affiliated Company, Net.* Equity in losses of affiliated company, net was \$277,000 in 2011 compared to \$213,000 in 2010. The increase in this amount is attributable to an increase in losses of our affiliated company and increase in our ownership of the affiliated company.

#### **Impact of Inflation, Devaluation and Fluctuation of Currencies on Results of Operations, Liabilities and Assets**

Since the majority of our revenues are paid in or linked to the U.S. dollar, we believe that inflation and fluctuations in the NIS/U.S. dollar exchange rate have no material effect on our revenues. However, a majority of the cost of our Israeli operations, mainly personnel and facility-related, is incurred in NIS. Inflation in Israel and U.S. dollar exchange rate fluctuations have some influence on our expenses and, as a result, on our net income. Our NIS costs, as expressed in U.S. dollars, are influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the NIS in relation to the U.S. dollar.

To protect against the changes in value of forecasted foreign currency cash flows resulting from payments in NIS, we maintain a foreign currency cash flow hedging program. We hedge portions of our forecasted expenses denominated in foreign currencies with forward contracts. These measures may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

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

Year Ended December 31,	Israeli inflation Rate %	NIS devaluation rate %	Israeli inflation adjusted for devaluation %
2010	2.7	(6.0)	6
2011	2.2	7.7	(5.5)
2012	1.4	(2.3)	3.7
Three months ended March 31, 2013	0	(0.7)	0.5

#### **Recent Accounting Pronouncements**

In February 2013, the FASB issued ASU No. 2013-02, Topic 350 - Comprehensive Income ("ASU 2013-02"), which amends Topic 220 to improve the reporting of reclassifications out of accumulated other comprehensive income to the respective line items in net income. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012. We intend to adopt this standard in 2013 and do not expect the adoption will have a material impact on our consolidated results of operations or financial condition.



## B. LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations for the last three years primarily from our cash and cash equivalents, bank deposits, bank borrowings and cash from operations.

As of December 31, 2012, we had \$58.5 million in cash and cash equivalents, marketable securities and bank deposits, a decrease of \$16.7 million from \$75.2 million at December 31, 2011. The decrease in this amount was primarily related to cash used for stock repurchases. As of December 31, 2012, we were restricted with respect to using approximately \$19.6 million of our cash as a result of provisions in our loan agreements, a lease agreement and foreign exchange derivatives transactions.

### *Senior Convertible Notes*

In November 2004, we issued \$125.0 million aggregate principal amount of our 2.00% Senior Convertible Notes due 2024. The Notes are convertible at a rate of \$18.71 per share, subject to adjustment in certain circumstances, such as changes in our capital structure or upon the issuance by us of share dividends or certain cash distributions. As of December 31, 2012, there was a total of \$353,000 in principal amount of the Notes outstanding as we repurchased all of the other Notes during 2008 and 2009.

### *Bank Loans*

In April and July 2008, we entered into loan agreements with two banks in Israel that provided for borrowings of an aggregate of \$30 million. The loans bear interest at an annual rate equal to LIBOR plus 1.3%-1.5% with respect to \$23 million of borrowings and LIBOR plus 0.5%-0.65% with respect to \$7.0 million of borrowings. The principal amount borrowed is repayable in 20 equal quarterly payments from August 2008 through July 2013. As of December 31, 2012, there was \$3.8 million principal amount of these borrowings outstanding.

In September and December 2011, we entered into loan agreements with banks in Israel that provided for borrowings of an aggregate of \$23.8 million. The loans bear interest at an annual rate equal to LIBOR plus 2.1%-4.35% with respect to \$19.9 million of these loans. As of December 31, 2012, we are required to maintain \$3.9 million as a compensating bank deposit. This portion of the loans bears interest at 0.5% above interest paid on the bank deposit. Of these borrowings, \$19.9 million of the principal amount borrowed is repayable in 20 equal quarterly payments and the remaining \$3.9 million of principal amount is repayable in 10 equal semiannual payments through September 2017. As of December 31, 2012, there was \$19.1 million principal amount of these borrowings outstanding.

As of December 31, 2012, we were required to maintain an aggregate of \$13.4 million of compensating bank deposits with respect to our banks loans.

The loan agreements require us, among other things, to maintain shareholders' equity at specified levels and to achieve certain levels of operating income. The agreements also restrict us from paying dividends. During 2012, we were not in compliance with some of the financial covenants contained in our loan agreements. Each of our lenders agreed to waive compliance with these covenants, subject to compliance with revised financial covenants during the remainder of 2012 and 2013, an increase in the interest rate with respect to one of the loans and an increase in required compensating balances. As of December 31, 2012, we were in compliance with the revised financial covenants in our loan agreements. If we are unable to comply with our revised financial covenants in the future, our lenders could require us to repay all of our outstanding loans.

As of December 31, 2012, the banks have a lien on our assets regarding all bank loans, and we are required to maintain compensating balances with the banks. The lien and the compensating balances relate to all of the loans made to us in 2008 and 2011. As of December 31, 2012, we were required to maintain \$13.4 million of compensating balances with the banks. The amount of the compensating balances we are required to keep decreases over time as we repay these loans.

As of December 31, 2012, we owed an aggregate of \$22.9 million under all of these borrowings.

#### *Share Repurchase Program*

In October 2011, our Board approved a program to allow us to repurchase up to 4,000,000 of our ordinary shares. Purchases would be made from time-to-time at the discretion of management subject, among other things, to our share price and market conditions. In 2011 and 2012, we repurchased a total of 3,964,351 ordinary shares at a total cost of \$10.7 million. As of October 2012, the authorized share repurchase program was completed.

#### *Cash from Operating Activities*

Our operating activities provided cash in the amount of \$3.0 million, primarily due to a decrease of \$6.5 million in trade receivables and \$3.6 million in inventories, as well as non-cash charges of \$2.9 million for depreciation and amortization and \$1.5 million for stock-based compensation expenses, offset in part by our net loss of \$4.2 million and decreases of \$5.5 million in trade payables and \$3.1 million in other payables and accrued expenses. Our trade receivables and our inventories decreased primarily because of our lower sales volume in 2012 compared to 2011.

Our operating activities used cash in the amount of \$1.3 million in 2011, primarily due to an increase in trade receivables in the amount of \$4.6 million and in inventories in the amount of \$4.1 million and a decrease in other payables and accrued expenses and other liabilities in the amount of \$5.5 million, partly offset by stock based compensation expenses in the amount of \$2.3 million and an increase in deferred revenue in the amount of \$2.0 million. Our trade receivables and our inventories increased primarily because of our higher sales volume in 2011 compared to 2010. Our trade and other payables decreased because of our lower cost of goods sold in 2011 than in 2010.

Our operating activities provided cash in the amount of \$16.4 million in 2010, primarily due to our net income of \$12.0 million, an increase in other payables and accrued expenses of \$8.2 million, non-cash depreciation and amortization in the amount \$4.4 million, non cash stock-based compensation expenses of \$1.4 million and an increase in trade payables in the amount of \$4.9 million, partly offset by an increase in trade receivables in the amount of \$7.4 million and in inventories in the amount of \$4.5 million. Our trade receivables and our inventories increased primarily because of our higher sales volume in 2010 compared to 2009. Our trade and other payables increased because of increased expenses relating to our higher sales volume in 2010.

#### *Cash from Investing Activities*

In 2012, our investing activities provided cash in the amount of \$1.4 million, primarily due to the net proceeds of \$3.7 million from short-term bank deposits, offset in part by \$2.0 million in purchases of property and equipment.

In 2011, our investing activities used cash in the amount of \$35.5 million, primarily due to purchase of marketable securities in the amount of \$24.4 million and investment in short-term and long-term bank deposits.

In 2010, our investing activities used cash in the amount of \$1.5 million, primarily due to purchase of property and equipment.

### *Cash from Financing Activities*

In 2012, we used \$17.4 million of cash in financing activities as a result of \$10.2 million used for repayment of bank loans and \$6.9 million used to repurchase our shares.

In 2011, we provided cash in financing activities of \$14.7 million as a result of \$24.0 million proceed from bank loans offset, in part, by the use of \$3.8 million to repurchase our shares and \$6.6 million to repay bank loans.

In 2010, we used cash in financing activities of \$3.6 million as a result of \$6.0 million used for repayment of bank loans offset, in part, by \$2.6 million in proceeds from issuance of shares upon exercise of options and purchases of shares under our employee stock purchase plan.

### *Financing Needs*

We anticipate that our operating expenses will be a material use of our cash resources for the foreseeable future. We believe that our current working capital is sufficient to meet our operating cash requirements for at least the next twelve months, including payments required under our existing bank loans. Part of our strategy is to pursue acquisition opportunities. If we do not have available sufficient cash to finance our operations and the completion of additional acquisitions, we may be required to obtain additional debt or equity financing. We cannot be certain that we will be able to obtain, if required, additional financing on acceptable terms or at all.

### *C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.*

#### *Research and Development*

In order to accommodate the rapidly changing needs of our markets, we place considerable emphasis on research and development projects designed to improve our existing products and to develop new ones. We are developing analog and digital media gateways for carrier and enterprise applications, multi service business gateways and session border controllers. Our platforms are expected to feature increased trunk capacity, new functionalities, enhanced signaling software and compliance with new control protocols. As of December 31, 2012, 225 of our employees were engaged primarily in research and development on a full-time basis.

Our research and development expenses were \$28.7 million in 2012 compared to \$32.2 million in 2011. From time to time we have received royalty-bearing grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS. As a recipient of grants from the OCS, we are obligated to perform all manufacturing activities for projects subject to the grants in Israel unless we receive an exemption. Know-how from the research and development which is used to produce products may not be transferred to third parties without the approval of the OCS and may further require significant payments. The OCS approval is not required for the export of any products resulting from such research or development. Through December 31, 2012, we had obtained grants from the OCS aggregating \$24 million for certain of our research and development projects. We are obligated to pay royalties to the OCS, amounting to 3%-6% of the sales of the products and other related revenues generated from such projects, up to 100% of the grants received, if no additional payments are required, linked to the U.S. dollar and bearing interest at the rate of LIBOR at the time of grant. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales no payment is required. As of December 31, 2012, we have contingent obligation to pay royalties in the amount of approximately \$29.4 million.

D. TREND INFORMATION

The accelerated demand for VoIP technology has impacted our business during the last few years. Over the past few years, the shift from traditional circuit-switched networks to next generation packet-switched networks has continued to gain momentum. As data traffic becomes the dominant factor in communications, service providers are building and maintaining converged networks for integrated voice and data services. In addition, underdeveloped markets without basic wire line service in countries such as China and India and certain countries in Eastern Europe are beginning to use VoIP technology to deliver voice and data services that were previously unavailable. In addition, the growth in broadband access and related technologies has driven the emergence of alternative service providers. This in turn stimulates competition with incumbent providers, encouraging them to adopt voice over packet technologies.

While the growth in demand for VoIP services helped create demand for our products and services, there is an ongoing transition in network architectures that could adversely affect the demand for our products. The growth of services over Internet Protocol (IP) and data usage services over legacy voice using TDM is driving the transition in network architecture. The demand for our media gateway products is based on the need to interconnect VoIP networks with traditional non-packet based networks. The demand for our Enterprise Session Border Control (ESBC) products is based on the need to interconnect LAN and WAN voice over packet networks with each other. The migration from traditional TDM networks to pure IP networks is gradually increasing. This could positively affect the demand for our ESBC products, but negatively affect the demand for our media gateway products.

We are experiencing decreasing demand for our technology products from customers who previously manufactured network equipment products based on our enabling technology. These customers are migrating from AudioCodes' enabling technology products to diverse integrated comprehensive solutions and, as a result, the demand for our technology products is being adversely affected.

We continue to experience pressure to shorten our lead times in supplying products to customers. Some of our customers are implementing "demand pull" programs by which they only purchase our products very close to the time, if not simultaneously with the time, they plan to sell their products. We are increasing our sales efforts in new markets, such as Latin America, Eastern Europe and Far East. We have introduced new system level products, and applications in our product lines. We are still experiencing low visibility into customer demand for our products which restricts our ability to predict our level of sales.

E. OFF-BALANCE SHEET ARRANGEMENTS

We do not have any "off-balance sheet arrangements" as this term is defined in Item 5E of Form 20-F.

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

As of December 31, 2012, our contractual obligations were as follows (dollars in thousands):

	PAYMENTS DUE BY PERIOD				TOTAL
	LESS THAN 1 YEAR	1-3 YEARS	3-5 YEARS	MORE THAN 5 YEARS	
Senior convertible notes		353			353
Bank loans	8,436	9,371	5105	-	22,913
Rent and lease commitments, net (1)	5,375	10,222	9,927	-	25,524
Accrued severance pay (2)					512
Uncertain tax positions (3)					394
Payment to NSC's former shareholders	506	-			506
Office of the Chief Scientist				29,413	29,413
Other commitments	1,174	-	-	-	1,174

(1) Our obligation for rent and lease commitments as of December 31, 2012 was approximately \$26.9 million. We have rent and lease income in the amount of approximately \$1.4 million, leaving a net obligation of approximately \$26.5 million.

(2) Our obligation for accrued severance pay under Israel's Severance Pay Law as of December 31, 2012 was \$16.3 million. This obligation is payable only upon termination, retirement or death of the respective employee. We have funded \$15.8 million through deposits into severance pay funds, leaving a net obligation of approximately \$512,000.

(3) Uncertain income tax position under ASC 740 (formerly FASB Interpretation No 48), "Income Taxes," are due upon settlement and we are unable to reasonably estimate the ultimate amount of timing of settlement. See also Note 14f in our Consolidated Financial Statements for further information regarding our liability under ASC 740.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth certain information with respect to our directors, senior executive officers and key employees at April 3, 2013:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Stanley B. Stern	56	Chairman of the Board of Directors
Shabtai Adlersberg	60	President, Chief Executive Officer and Director
Guy Avidan	50	Vice President of Finance and Chief Financial Officer
Lior Aldema	47	Chief Operating Officer and Head of Global Sales
Jeffrey Kahn	55	Chief Strategy Officer
Eyal Frishberg	54	Vice President, Operations
Yehuda Herscovici	45	Vice President, Systems
Nimrod Borovsky	42	Vice President, Unified Communications
Tal Dor	43	Vice President, Human Resources
Ofer Nimitsovich	44	Vice President, Global Services
Joseph Tenne(1)(2)(3)	57	Director
Dr. Eyal Kishon(1)(2)(3)(4)	53	Director
Doron Nevo(1)(2)(3)(4)	57	Director
Dana Gross	46	Director

(1) Member of Audit Committee

(2) Member of Nominating Committee

(3) Member of Compensation Committee

(4) Outside Director

*Stanley Stern* became a director and our Chairman of the Board in December 2012. From 2008 until 2013 Mr. Stern served in various positions at Oppenheimer & Co., including as a Managing Director and Head of Technology, Israeli Banking and FIG. Since 2013, Mr. Stern has served as the president of Alnitak Capital, a private merchant bank and strategic advisory firm. From March 2004 until December 2007, he served as a Managing Director and Head of Investment Banking at Oppenheimer. From 2002 until 2004, he was a Managing Director and the Head of Investment Banking at C.E. Unterberg, Towbin where he focused on technology and defense related sectors. From January 2000 until January 2002, Mr. Stern was the President of STI Ventures Advisory USA Inc., a venture capital firm focusing on technology investments. Prior to his term at STI Ventures, he spent over 20 years at CIBC Oppenheimer in the investment banking department and started the technology banking group in 1990. From 2002 until 2012, Mr. Stern served as the Chairman of the Board of Directors of Tucows, Inc., an internet service provider that is public traded company on AMEX, and, since 2012, he has continued to serve as a Director of Tucows, Inc. Since 2012 he has also served as a director of Given Imaging Ltd., a NASDAQ-listed manufacturer of GI medical devices. From 2004 until 2009, he served as a director of Odimo Inc., an online jewelry vendor. From 2005 until its sale in 2011, he served as a director and Chairman of the Audit Committee of Fundtech Ltd. Mr. Stern received his MBA from Harvard Business School and a BS from Queens College.

*Shabtai Adlersberg* co-founded AudioCodes in 1993, and has served as our President, Chief Executive Officer and a director since inception. Until December 2012, Mr. Adlersberg also served as the Chairman of our Board of Directors. Mr. Adlersberg co-founded DSP Group, a semiconductor company, in 1987. From 1987 to 1990, Mr. Adlersberg served as the Vice President of Engineering of DSP Group, and from 1990 to 1992, he served as Vice President of Advanced Technology. As Vice President of Engineering, Mr. Adlersberg established a research and development team for digital cellular communication which was spun-off in 1992 as DSP Communications. Mr. Adlersberg also serves as Chairman of the Board of Directors of Natural Speech Communication Ltd. and as a director of CTI Squared Ltd. Mr. Adlersberg holds an M.Sc. in Electronics and Computer Engineering from Tel Aviv University and a B.Sc. in Electrical Engineering from the Technion-Israel Institute of Technology, or the Technion.

*Guy Avidan* has served as our Vice President of Finance and Chief Financial Officer since July 2010. Prior to joining AudioCodes, Mr. Avidan served for 15 years in various managerial positions at MRV Communications Inc., a global provider of optical communications network infrastructure equipment and services. Most recently, Mr. Avidan served as Co-President of MRV Communications. Prior to that, he served as Chief Financial Officer of MRV Communications between 2007 and 2009. He also served as Vice President and General Manager of MRV International from September 2001 to July 2007. Prior to joining MRV Communications, from 1992 to 1995, Mr. Avidan served as Vice President of Finance and Chief Financial Officer of Ace North Hills, which was acquired by MRV. Mr. Avidan is a CPA in Israel and holds a B.A. degree in Economics and Accounting from Haifa University.

*Lior Aldema* has served as Chief Operating Officer since January 2010, and as our Head of Global Sales since April 2012. Previously, he served as our Vice President, Product Management from 2002 until 2009, as well as our Vice President Marketing from February 2003 until 2009. He has been employed by us since 1998, when he was team leader and later headed our System Software Group in our research and development department. Prior to 1998, Mr. Aldema served as an officer in the Technical Unit of the Intelligence Corps of the Israeli Defense Forces (Major), heading both operational units and large development groups related to various technologies. Mr. Aldema holds an M.B.A. from Tel Aviv University and a B.Sc. from the Technion.

*Jeffrey Kahn* has served as our Chief Strategy Officer since January 2010. Prior to joining us, Mr. Kahn served as Founder and Managing Director of Strategy3i, a global consultancy that he established in 2007 to provide counseling to leading global companies, including Pfizer, Unicredit and Renova, among others. From 2005 to 2007, Mr. Kahn served as a director of investment banking at Maxim Group LLC, and from 1995 to 2005 he served as the Chief Strategic Officer of Ruder Finn International, one of the world's largest and oldest independent global communications firms. Mr. Kahn holds a B.A. in international relations and psychology from Brooklyn College and has done graduate studies in international relations and psychology at Tel Aviv University.

*Eyal Frishberg* has served as our Vice President, Operations since October 2000. From 1997 to 2000, Mr. Frishberg served as Associate Vice President, SDH Operations in ECI Telecom Ltd., a major telecommunication company. From 1987 to 1997, Mr. Frishberg worked in various operational positions in ECI Telecom including as manager of ECI production facility and production control. Mr. Frishberg worked from 1994 until 1997 for ELTA company, part of Israeli Aircraft Industries in the planning and control department. Mr. Frishberg holds a B.Sc. in Industrial Engineering from Tel Aviv University and an M.B.A. from Ben-Gurion University of the Negev.

*Yehuda Herscovici* has served as our Vice President, Systems Group since 2003. From 2001 to 2003, Mr. Herscovici served as our Vice President, Advanced Products. From 2000 to 2001, Mr. Herscovici served as our Director of Advanced Technologies. From 1994 to 1998 and during 1999, Mr. Herscovici held a variety of research and development positions at Advanced Recognition Technologies, Ltd., a voice and handwriting recognition company, heading its research and development from 1999 to 2000 as Vice President, Research and Development. From 1998 to 1999, Mr. Herscovici was engaged in developing various wireless communication algorithms at Comsys, a telecommunications company. Mr. Herscovici holds an M.Sc. and a B.Sc., from the Technion both in the area of telecommunications.

*Tal Dor* has served as our Vice President of Human Resources since March 2000. Prior to March 2000, Ms. Dor acted for several years as a consultant in Israel to, among others, telephone and cable businesses, as well as health and social service organizations. Ms. Dor holds a B.A. in psychology, from Ben-Gurion University of the Negev and an M.A. in psychology from Tel Aviv University.

*Nimrod Borovsky* has served as our Vice President of Unified Communications since January 2013 and heads the strategic business development efforts with AudioCodes unified communications partners and channels. Mr. Borovsky has been with AudioCodes since 2005 and has served in numerous product, marketing and business development positions with us. He has worked in telecom and VoIP markets for almost 20 years. Prior to joining AudioCodes, Mr. Borovsky spent eight years at VocalTec Communications where he served in several positions in research and development, product management and marketing. Mr. Borovsky holds a B.Sc. degree in Electrical Engineering from the New Jersey Institute of Technology, and a M.Sc. degree in Biomedical engineering from Tel Aviv University.

*Ofer Nimitsovich* joined AudioCodes in March 2013 as Vice President, Global Services. From 2000 until February 2013, Mr. Nimitsovich served in various executive positions at Retalix, including Chief Information Officer, Executive Vice President of Global Services and, most recently as the head of the Software as a Service division of Retalix. From 1994 till 2000, Mr. Nimitsovich worked for Scitex Corporation Ltd., where he held various technical and management positions, including as the Global Microsoft Infrastructure manager for Scitex. Mr. Nimitsovich graduated from the Business Administration College in Israel in 1997 with a B.A. in Business administration and marketing, and also holds an MBA degree from the University of Texas.

*Joseph Tenne* has served as one of our directors since June 2003. From March 2005 until April 2013, Mr. Tenne served as the Chief Financial Officer of Ormat Technologies, Inc., a company listed on the New York Stock Exchange, which is engaged in the geothermal and recovered energy business. From January 2006 until April 2013, Mr. Tenne also served as the Chief Financial Officer of Ormat Industries Ltd., an Israeli holding company listed on the Tel-Aviv Stock Exchange and the parent company of Ormat Technologies, Inc. From 2003 to 2005, Mr. Tenne was the Chief Financial Officer of Treofan Germany GmbH & Co. KG, a German company, which is engaged in the development, production and marketing of oriented polypropylene films, which are mainly used in the food packaging industry. From 1997 until 2003, Mr. Tenne was a partner in Kesselman & Kesselman, Certified Public Accountants in Israel and a member of PricewaterhouseCoopers International Limited. Mr. Tenne holds a B.A. in Accounting and Economics and an M.B.A. from Tel Aviv University. Mr. Tenne is also a Certified Public Accountant in Israel.

*Dr. Eyal Kishon* has served as one of our directors since 1997. Since 1996, Dr. Kishon has been Managing Partner of Genesis Partners, an Israel-based venture capital fund. From 1993 to 1996, Dr. Kishon served as Associate Director of Dovrat-Shrem/Yozma-Polaris Fund Limited Partnership. Prior to that, Dr. Kishon served as Chief Technology Officer at Yozma Venture Capital from 1992 to 1993. Dr. Kishon serves as a director of Allot Communications Ltd and Celtra Inc. From 1991 to 1992, Dr. Kishon was a Research Fellow in the Multimedia Department of IBM Science & Technology. From 1989 to 1991, Dr. Kishon worked in the Robotics Research Department of AT&T Bell Laboratories. Dr. Kishon holds a B.A. in Computer Science from the Technion - Israel Institute of Technology and an M.Sc. and a Ph.D. in Computer Science from New York University.

*Doron Nevo* has served as one of our directors since 2000. Mr. Nevo is President and CEO of KiloLambda Technologies Ltd., an optical nano-technology company, which he co-founded in 2001. From 1999 to 2001, Mr. Nevo was involved in fund raising activities for Israeli-based startup companies. From 1996 to 1999, Mr. Nevo served as President and CEO of NKO, Inc. Mr. Nevo established NKO in early 1995 as a startup subsidiary of Clalcom, Ltd. NKO designed and developed a full scale, carrier grade, IP telephony system platform and established its own IP network. From 1992 to 1996, Mr. Nevo was President and CEO of Clalcom Ltd. Mr. Nevo established Clalcom in 1992 as a telecom service provider in Israel. He also serves as a director of Etgar - Portfolio Management Trust Co. and of a number of private companies. Mr. Nevo holds a B.Sc. in Electrical Engineering from the Technion - Israel Institute of Technology and an M.Sc. in Telecommunications Management from Brooklyn Polytechnic.

*Dana Gross* has served as one of our directors since November 2010. She also served as one of our directors between 2000 and 2006. From 2009 until February 2013, Ms. Gross was a Venture Partner at Carmel Ventures, a leading Israeli venture capital firm. From 2006 to 2008, Ms. Gross was a Senior Vice President, Israel Country Manager at SanDisk Corporation, a manufacturer of flash memory cards. From 1992 to 2006, Ms. Gross held various senior positions at M-Systems, a manufacturer of flash memory cards that was acquired by SanDisk, including Chief Marketing Officer, Vice President, World Wide Sales, President of M-Systems Inc. (U.S. subsidiary of M-Systems) and CFO, Vice President, Finance and Administration. In addition, Ms. Gross has served as a director of Tower Semiconductor Ltd. since 2009, and served as a director of M-Systems Ltd. from 1999 to 2006 and PowerDsine Ltd. from 2004 to 2007. Ms. Gross holds a B.Sc. in Industrial Engineering from Tel-Aviv University and an M.A. in business administration from San Jose State University.

## B. COMPENSATION

The aggregate direct remuneration paid during the year ended December 31, 2012 to the 13 persons who served in the capacity of director, senior executive officer or key employee during 2012 was approximately \$2.9 million, including approximately \$331,000 which was set aside for pension and retirement benefits. The compensation amounts do not include amounts expended by us for automobiles made available to our officers, expenses (including business, travel, professional and business association dues and expenses) reimbursed to officers and other fringe benefits commonly reimbursed or paid by companies in Israel.

We currently pay each of our non-employee directors an annual fee of \$34,000 and a fee of \$1,000 for each board meeting or committee meeting attended. In the event that a director attends a meeting by phone or a resolution is adopted by written consent, then the fee is reduced to 60% and 50% of the regular meeting fee, respectively. Such fees are in accordance with the rates prescribed by the Israeli Companies Law Regulation for fees of outside directors. Only directors who are not officers receive compensation for serving as directors. Our director, Mr. Adlersberg, who also serves as our President and Chief Executive Officer, does not receive board meeting fees. Instead, he receives compensation in accordance with the terms of his employment agreement, a copy of which is filed as an exhibit to this Annual Report.

Upon election or reelection to the board of directors for a term of three years, each non-employee director is granted options to purchase 22,500 ordinary shares, of which 7,500 vest on each of the first, second and third anniversary of the grant date. Each grant is subject to the approval of the compensation committee, board of directors and shareholders. All options to directors are granted at an exercise price equal to 100% of the closing price of the ordinary shares on the NASDAQ Global Select Market on the date of grant.



Stock options to purchase our ordinary shares granted under our 2008 Stock Option Plans to persons who served in the capacity of director or executive officer are generally exercisable at the fair market value at the date of grant and expire seven years from the date of grant. The options are generally exercisable in four equal annual installments, commencing one year from the date of grant.

A summary of our stock option and restricted share units (“RSUs”) activity and related information for the years ended December 31, 2010, 2011 and 2012 for the persons who served in the capacity of director, senior executive or key employee officer during those years is as follows:

	2010		2011		2012	
	Number of Options and RSUs	Weighted Average Exercise Price	Number of Options and RSUs	Weighted Average Exercise Price	Number of Options and RSUs	Weighted Average Exercise Price
Outstanding at the beginning of the year	1,865,928	\$ 6.44	1,710,620	\$ 6.07	1,314,449	\$ 3.94
Granted	682,108	\$ 3.77	349,601	\$ 1.76	374,335	\$ 2.20
Cancelled	(536,951)		(577,500)		(150,000)	
Exercised	(300,465)	\$ 2.43	(168,272)	\$ 0.66	(56,788)	\$ 0.56
Outstanding at the end of the year	<u>1,710,620</u>	<u>\$ 6.07</u>	<u>1,314,449</u>	<u>\$ 3.94</u>	<u>1,481,996</u>	<u>\$ 3.60</u>

As of December 31, 2012, options to purchase 680,377 ordinary shares were exercisable by the 12 persons who served as an officer or director during 2012 at an average exercise price of \$4.63 per share.

### C. BOARD PRACTICES

#### Corporate Governance Practices

We are incorporated in Israel and therefore are subject to various corporate governance practices under the Israeli Companies Law, 1999, or the Companies Law, relating to such matters as outside directors, the audit committee, the internal auditor and approvals of interested party transactions. These matters are in addition to the ongoing listing conditions of the NASDAQ Global Select Market and other relevant provisions of U.S. securities laws. Under the NASDAQ rules, a foreign private issuer may generally follow its home country rules of corporate governance in lieu of the comparable NASDAQ requirements, except for certain matters such as composition and responsibilities of the audit committee and the independence of its members. For further information, see Item 16G – “Corporate Governance.”

#### Independent Directors

Under the Companies Law, Israeli companies that have offered securities to the public in or outside of Israel are required to appoint at least two “outside” directors. Doron Nevo and Dr. Eyal Kishon currently serve as our outside directors. Under the requirements for listing on the NASDAQ Global Select Market, a majority of our directors are required to be independent as defined by NASDAQ rules. Doron Nevo, Dr. Eyal Kishon, Dana Gross and Joseph Tenne qualify as independent directors under the applicable Securities and Exchange Commission and NASDAQ rules, as well as under the Companies Law.

Under the Companies Law, a person may not serve as an outside director if at the date of the person's election or within the prior two years the person is a relative of the company's controlling shareholder, or the person or his or her relatives, partners, employers, supervisors or entities under the person's control, have or had any affiliation with us or with a controlling shareholder or relatives of a controlling shareholder, and, in the case of a company without a controlling shareholder or a shareholder holding at least 25% of the voting rights, any affiliation, at the time of election, to the chairman of the board of directors, the chief executive officer, an interested party or the company's most senior finance officer. Under the Companies Law, "affiliation" includes:

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

In addition, a person may not serve as an outside director:

- if the person or his or her relatives, partners, employers, supervisors or entities under the person's control, maintains a business or professional relationship with the company, even if such relationship is not on a regular basis, other than a negligible business or professional relationship, or
- if the person received compensation as an outside director in excess of the amounts permitted by the Companies Law and regulations there under.

In addition, no individual may serve as an outside director if the individual's position or other activities create or may create a conflict of interest with his or her role as an outside director or are likely to interfere with his or her ability to serve as a director. Until the lapse of two years from the termination of office, the company, a controlling shareholder and entities under the company's control may not grant the outside director or any of his or her relatives, directly or indirectly, any benefit, or engage the outside director or his or her relatives as an office holder of the company, of a controlling shareholders or of an entity under the company's control, and may not employ or receive services from the outside director or any of his or her relatives, either directly or indirectly, including through a corporation controlled by that person. The restriction on a relative that is not the spouse or child of the outside director is limited to one year from the termination of office instead of two years. Pursuant to the Companies Law, at least one of the outside directors appointed by a publicly-traded company must have "financial and accounting expertise." The other outside directors are required to possess "financial and accounting expertise" or "professional expertise," as these terms are defined in regulations promulgated under the Companies Law. Joseph Tenne is designated as the "audit committee financial expert" as that term is defined in Securities and Exchange Commission rules.

Outside directors are elected by a majority vote at a shareholders' meeting. In addition to the majority vote, the shareholder approval of the election of an outside director must satisfy either of two additional tests:

- the majority includes at least a majority of the shares voted by shareholders other than our controlling shareholders or shareholders who have a personal interest in the election of the outside directors (excluding a personal interest that is not related to a relationship with the controlling shareholders); or

the total number of shares held by non-controlling shareholders and disinterested shareholders that voted against the election of the outside director does not exceed 2% of the aggregate voting rights of our company.

The term of an outside director is three years and may be extended for additional three-year terms. An outside director can be removed from office only under very limited circumstances. All of the outside directors must serve on a company's statutory audit committee and compensation committee (including one outside director serving as the chair of the audit committee and one outside director serving as the chair of the compensation committee) and each other committee of a company's board of directors is required to include at least one outside director. If, at the time an outside director is elected, all current members of the board of directors that are not controlling shareholders or their respective relatives are of the same gender, then the elected outside director must be of the other gender.

Pursuant to the Companies Law, an Israeli company whose shares are publicly traded may elect to adopt a provision in its articles of association pursuant to which a majority of its board of directors (or a third of its board of directors in case the company has a controlling shareholder) will constitute individuals complying with certain independence criteria prescribed by the Companies Law. Pursuant to the regulations, directors who comply with the independence requirements of the NASDAQ and Securities and Exchange Commission regulations are deemed to comply with the independence requirements of the Companies Law. We have not included such a provision in our articles of association since our board of directors complies with the independence requirements of the NASDAQ and Securities and Exchange Commission regulations described above. In any event, as described above, a majority of our board of directors and all members of our audit committee are directors who comply with the independence criteria prescribed by the Companies Law.

### **Audit Committee**

Under the Companies Law and the requirements for listing on the NASDAQ Global Select Market, our board of directors is required to appoint an audit committee. Our audit committee must be comprised of at least three directors, including all of the outside directors (one of whom must serve as the chair of the audit committee), and a majority of the committee members must comply with the director independence requirements prescribed by the Companies Law. The audit committee consists of: Dr. Eyal Kishon, Doron Nevo and Joseph Tenne, with Doron Nevo serving as the chairman of the audit committee. Our board of directors has determined that Joseph Tenne is an "audit committee financial expert" as defined in Securities and Exchange Commission rules and that all members of the audit committee are independent under the applicable Securities and Exchange Commission rules, NASDAQ rules and provisions of the Companies Law.

The audit committee may not include the chairman of the board, or any director employed by us, by a controlling shareholder or by any entity controlled by a controlling shareholder, or any director providing services to us, to a controlling shareholder or to any entity controlled by a controlling shareholder on a regular basis, or any director whose income is primarily dependent on a controlling shareholder, and may not include a controlling shareholder or any relatives of a controlling shareholder. Individuals who are not permitted to be audit committee members may not participate in the committee's meetings other than to present a particular issue. However, an employee who is not a controlling shareholder or relative may participate in the committee's discussions but not in any vote, and the company's legal counsel and corporate secretary may participate in the committee's discussions and votes if requested by the committee.

Under the Companies Law, a meeting of the audit committee is properly convened if a majority of the committee members attend the meeting, and in addition a majority of the attending committee members are independent directors within the meaning of the Companies Law and include at least one outside director.

We have adopted an audit committee charter as required by NASDAQ rules. The audit committee's duties include providing assistance to the board of directors in fulfilling its legal and fiduciary obligations in matters involving our accounting, auditing, financial reporting, internal control and legal compliance functions by approving the fees of, and services performed by, our independent accountants and reviewing their reports regarding our accounting practices and systems of internal accounting controls. The audit committee also oversees the audit efforts of our independent accountants and takes those actions as it deems necessary to satisfy itself that the accountants are independent of management. Under the Companies Law, the audit committee also is required to monitor deficiencies in the administration of our company, including by consulting with the internal auditor and independent accountants, to review, classify and approve related party transactions and extraordinary transactions, to review the internal auditor's audit plan and to establish and monitor whistleblower procedures.

### **Nominating Committee**

NASDAQ rules require that director nominees be selected or recommended for the board's selection either by a committee composed solely of independent directors or by a majority of independent directors. Our Nominating Committee assists the board of directors in its selection of individuals as nominees for election to the board of directors and/or to fill any vacancies or newly created directorships on the board of directors. The Nominating Committee consists of Dr. Eyal Kishon, Doron Nevo and Joseph Tenne, with Doron Nevo serving as the chairman of the Nominating Committee. All members of the Nominating Committee are independent under the applicable NASDAQ rules and provisions of the Companies Law.

### **Compensation Committee**

Under the Companies Law, the board of directors of any public company must establish a compensation committee. The compensation committee must consist of at least three directors, include all of the outside directors (including one outside director serving as the chair of the compensation committee), and a majority of the committee members must comply with the director independence requirements prescribed by the Companies Law. Similar to the rules that apply to the audit committee, the compensation committee may not include the chairman of the board, or any director employed by us, by a controlling shareholder or by any entity controlled by a controlling shareholder, or any director providing services to us, to a controlling shareholder or to any entity controlled by a controlling shareholder on a regular basis, or any director whose primary income is dependent on a controlling shareholder, and may not include a controlling shareholder or any of its relatives. Individuals who are not permitted to be compensation committee members may not participate in the committee's meetings other than to present a particular issue; *provided, however*, that an employee that is not a controlling shareholder or relative may participate in the committee's discussions, but not in any vote, and the company's legal counsel and corporate secretary may participate in the committee's discussions and votes if requested by the committee.

The compensation committee's duties include recommending to the board of directors a compensation policy for executives and monitor its implementation, approve compensation terms of executive officers, directors and employees affiliated with controlling shareholders, make recommendations to the board of directors regarding the issuance of equity incentive awards under our equity incentive plan and exempt certain compensation arrangements from the requirement to obtain shareholder approval under the Companies Law. The compensation committee meets at least twice a year, with further meetings to occur, or actions to be taken by unanimous written consent, when deemed necessary or desirable by the committee or its chairperson.

The compensation committee consists of: Dr. Eyal Kishon, Doron Nevo and Joseph Tenne, with Doron Nevo serving as the chairman of the compensation committee. All members of the compensation committee are independent under the applicable Securities and Exchange Commission rules, NASDAQ rules and provisions of the Companies Law.

## **Internal Auditor**

Under the Companies Law, our board of directors is also required to appoint an internal auditor proposed by the audit committee. The internal auditor may be our employee, but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of our independent accounting firm. The role of the internal auditor is to examine, among other things, whether our activities comply with the law and orderly business procedure. Brightman, Almagor Zohar & Co. (a member firm of Deloitte & Touche in Israel) has been our internal auditor since November 2008.

## **Board Classes**

Pursuant to our articles of association, our directors, other than our outside directors, are classified into three classes (classes I, II and III). The members of each class of directors and the expiration of the term of office are as follows:

Dana Gross	Class I	2013
Joseph Tenne	Class II	2014
Shabtai Adlersberg	Class III	2015
Stanley B. Stern	Class III	2015

Our outside directors under the Companies Law, Doron Nevo and Dr. Eyal Kishon, are not members of any class and serve in accordance with the provisions of the Companies Law. Dr. Kishon's term ends in 2014 and Mr. Nevo's term ends in 2015.

## **Chairman of the Board**

Under the Companies Law, the chief executive officer of a company (or a relative of the chief executive officer) may not serve as the chairman of the board of directors, and the chairman of the board of directors (or a relative of the chairman of the board of directors) may not serve as the chief executive officer, unless approved by the shareholders by a special majority vote prescribed by the Companies Law. The shareholder vote cannot authorize the appointment for a period of longer than three years, which period may be extended from time to time by the shareholders with a similar special majority vote. The chairman of the board of directors shall not hold any other position with the company (except as chief executive officer if approved in accordance with the above procedure) or in any entity controlled by the company, other than as chairman of the board of directors of a controlled entity, and the company shall not delegate to the chairman duties that, directly or indirectly, make him or her subordinate to the chief executive officer.

## EMPLOYEES

We had the following number of employees as of December 31, 2010, 2011 and 2012 in the areas set forth in the table below:

	As of December 31,		
	2010	2011	2012
Research and development	270	266	225
Sales and marketing, technical service and support	211	238	231
Operations	91	88	83
Management and administration	40	42	40
	<u>612</u>	<u>634</u>	<u>579</u>

Our employees were located in the following areas as of December 31, 2010, 2011 and 2012.

	As of December 31,		
	2010	2011	2012
Israel	394	402	352
United States	132	135	118
Europe	25	28	28
Far East	52	55	69
Latin America	9	14	12
	<u>612</u>	<u>634</u>	<u>579</u>

The decrease in the number of employees in 2012 was primarily attributable to our plan to restructure our operations in order to better align our resources and assets to our core networking and enterprise telephony businesses. The increase in the number of employees in 2010 and in 2011 was primarily attributable to an increase in sales and marketing personnel.

Israeli labor laws and regulations are applicable to our employees in Israel. These laws principally concern matters such as paid annual vacation, paid sick days, length of the workday, pay for overtime, insurance for work-related accidents, severance pay and other conditions of employment. Israeli law generally requires severance pay, which may be funded by Manager's Insurance, described below, upon the retirement or death of an employee or termination of employment without cause (as defined under Israeli law). Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which include payments for national health insurance. The payments to the National Insurance Institute currently range from approximately 7% to 17% of wages up to specified wage levels, of which the employee contributes approximately 49% and the employer contributes approximately 51%.

Our employees are subject to certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists Associations) by order of the Israeli Minister of Industry, Trade and Labor. These provisions principally concern cost of living increases, recreation pay and other conditions of employment. We generally provide our employees with benefits and working conditions above the required minimums. Our employees, as a group, are not currently represented by a labor union. To date, we have not experienced any work stoppages.

Pursuant to an order issued in December 2007 by the Israeli Minister of Industry, Trade and Labor, provisions relating to pension arrangements in the collective bargaining agreements between the Histadrut and the Coordination Bureau of Economic Organizations will apply to all employees in Israel, including our employees in Israel. We regularly contribute to a “Manager’s Insurance Fund” or to a privately managed pension fund on behalf of our employees located in Israel. These funds provide employees with a lump sum payment upon retirement (or a pension, in case of a pension fund) and severance pay, if legally entitled thereto, upon termination of employment. We provide for payments to a Manager’s Insurance Fund and pension fund contributions in the amount of 13.3% of an employee’s salary on account of severance pay and provident payment or pension, with the employee contributing 5.0% of his salary. We also pay an additional amount of up to 2.5% of certain of our employees’ salaries in connection with disability payments. In addition, we administer an Education Fund for our Israeli employees and pay 7.5% of these employees’ salaries thereto, with the employees contributing 2.5% of their salary.

**D. SHARE OWNERSHIP**

The following table sets forth the share ownership and outstanding number of options of our directors and officers as of April 3, 2013.

Name	Total Shares Beneficially Owned	Percentage of Ordinary Shares	Number of Options
Shabtai Adlersberg	5,278,780	13.9%	212,898
Stanley B. Stern	*		*
Guy Avidan	*		*
Lior Aldema	*		*
Jeffrey Kahn	*		*
Eyal Frishberg	*		*
Yehuda Herscovici	*		*
Nimrod Borovsky	*		*
Tal Dor	*		*
Ofer Nimitsovich	*		*
Joseph Tenne	*		*
Dr. Eyal Kishon	*		*
Doron Nevo	*		*
Dana Gross	*		*

\* Less than one percent.

Our officers and directors have the same voting rights as our other shareholders.

The following table sets forth information with respect to the options to purchase our ordinary shares held by Mr. Adlersberg as of April 3, 2013.

Number of Options	Grant Date	Exercise Price	Exercised	Cancelled	Vesting	Expiration Date
120,808	December 14, 2009	\$ 2.57	-	-	4 years	December 14, 2016
123,456	December 14, 2010	\$ 5.83	-	-	4 years	December 14, 2017
122,201	December 14, 2011	\$ 3.66	-	-	4 years	December 14, 2018
113,876	December 14, 2012	\$ 3.02	-	-	4 years	December 14, 2019

The following table sets forth information with respect to the RSUs granted to Mr. Adlersberg as of April 3, 2013. These RSUs vest quarterly over a four-year period from the date of grant, subject to his continuing service to us.

Number of RSUs	Grant Date	issued
40,269	December 14, 2009	32,718
41,152	December 14, 2010	23,148
40,734	December 14, 2011	12,728
37,959	December 14, 2012	2,372

### Employee Share Plans

We have Employee Share Purchase Plans for the sale of shares to our employees and Employee Share Option Plans for the granting of options to our employees, officers, directors and consultants. Most of these plans are pursuant to the Israeli Income Tax Ordinance, entitling the beneficiaries who are our employees to tax benefits under Israeli law. There are various conditions that must be met in order to qualify for these benefits, including registration of the options in the name of a trustee for each of the beneficiaries who is granted options. For tax benefits each option, and any ordinary shares acquired upon the exercise of the option, must be held by the trustee at least for a period commencing on the date of grant and ending no later than 24 months after the date of grant, in accordance with the period of time specified by Section 102 of Israel's Income Tax Ordinance, and deposited in trust with the trustee.

#### Employee Share Option Plans

**2008 Equity Incentive Plan.** We adopted an equity incentive plan under Section 102 of the Israeli Income Tax Ordinance, or Section 102, which provides certain tax benefits in connection with share-based compensation to employees, officers and directors. This plan, our 2008 Equity Incentive Plan, was approved by the Israeli Tax Authority.

Under our equity incentive plan, we may grant our directors, officers and employees restricted shares, restricted share units and options to purchase our ordinary shares under Section 102. We may also grant other persons awards under our equity incentive plan. However, such other persons (controlling shareholders and consultants) will not enjoy the tax benefits provided by Section 102. The total number of ordinary shares that were originally available for grant under the 2008 Plan was 2,009,122, which was increased in 2010 to 4,009,122. This number is reduced by one share for each equity grant we make under the 2008 Plan. During 2012, options to purchase 927,376 ordinary shares and 70,215 restricted share units were granted under the 2008 Plan. As of December 31, 2012, 660,979 ordinary shares remained available for grant under the 2008 Plan. As of December 31, 2012 there are 3,777,032 options to purchase ordinary shares and 182,161 restricted share units outstanding under the plan.

The Israeli Tax Authority approved the 2008 Plan under the capital gains tax track of Section 102. Based on Israeli law currently in effect and the election of the capital gains tax track, and provided that options, restricted shares and restricted shares units granted or, upon their exercise or vesting, the underlying shares, issued under the plan are held by a trustee for the two years following the date in which such awards are granted, our employees, officers and directors will be (i) entitled to defer any taxable event with respect to the awards until the underlying ordinary shares are sold, and (ii) subject to capital gains tax of 25% on the sale of the shares. However, if we grant awards at a value below the underlying shares' market value at the date of grant, the 25% capital gains tax rate will apply only with respect to capital gains in excess of the underlying shares' market value at the date of grant and the remaining capital gains will be taxed at the grantee's regular tax rate. We may not recognize a tax benefit pertaining to the employees' restricted shares, restricted share units and options for tax purposes except in the events described above under which the gain is taxed at the grantee's regular tax rate.



Restricted shares, restricted share units and options granted under the 2008 Plan will generally vest over four years from the grant date. If the employment of an employee is terminated for any reason, the employee (or in the case of death, the designated beneficiary) may exercise his or her vested options within ninety days of the date of termination (or within twelve months of the date of termination in the case of death or disability) and shall be entitled to any rights upon vested restricted shares and vested restricted share units to be delivered to the employee to the extent that they were vested prior to the date his or her employment terminates. Directors are generally eligible to exercise his or her vested options within twelve months from the date the director ceases to serve on the board of directors.

As of December 31, 2010, we recorded equity-based compensation as a liability based on its fair value in the amount of \$500,000 relating to a commitment to grant restricted share units that were granted in January 2011. In addition, we recorded a liability based on its fair value in the amount of \$160,000 relating to a commitment to grant restricted share units subject to our share price in the period in between the grant date and January 1, 2013.

The holders of options under all of the plans are responsible for all personal tax consequences relating to the options. The exercise prices of the options are based on the fair value of the ordinary shares at the time of grant as determined by our board of directors. The current practice of our board of directors is to grant options with exercise prices that equal 100% of the closing price of our ordinary shares on the applicable date of grant.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

To our knowledge, (A) we are not directly or indirectly owned or controlled (i) by another corporation or (ii) by any foreign government and (B) there are no arrangements, the operation of which may at a subsequent date result in a change in control of AudioCodes. The following table sets forth, as of April 3, 2013 the number of our ordinary shares, which constitute our only outstanding voting securities, beneficially owned by (i) all shareholders known to us to own more than 5% of our outstanding ordinary shares, and (ii) all of our directors and senior executive officers as a group.

Identity of Person or Group	Amount Owned	Percent of Class
Shabtai Adlersberg <sup>(1)</sup>	5,491,678	14.5%
Leon Bialik <sup>(2)</sup>	4,079,322	10.7%
Rima Management, LLC <sup>(3)</sup>	3,984,316	10.5%
All directors and senior executive officers as a group (11 persons) <sup>(4)</sup>	5,999,178	14.3%

(1) Includes options to purchase 212,898 shares, exercisable within 60 days of April 3, 2013.

(2) The information is derived from a statement on Schedule 13G/A, dated February 22, 2013 of Leon Bialik filed with the Securities and Exchange Commission.

(3) The information is derived from a statement on Schedule 13G, dated December 10, 2012, of Rima Management, LLC and Richard Mashaal filed with the Securities and Exchange Commission.

(4) Includes 719,148 ordinary shares which may be purchased pursuant to options exercisable within sixty days following March 31, 2013.

Mr. Adlersberg held 14.4% of our ordinary shares as of December 31, 2012 as compared to 12.9% of our ordinary shares as of December 31, 2011 and 13.5% of our ordinary shares as of December 31, 2010.

Mr. Bialik held 10.7% of our ordinary shares as of December 31, 2012 as compared to 10.0% of our ordinary shares as of December 31, 2011 and 9.9% of our ordinary shares as of December 31, 2010.

Rima Management, LLC held 10.5% of our ordinary shares as of December 31, 2012 as compared to 9.5% of our ordinary shares as of December 31, 2011 and 8.6% of our ordinary shares as of December 31, 2010.

As of April 9, 2013, there were approximately 19 holders of record of our ordinary shares in the United States, although we believe that the number of beneficial owners of the ordinary shares is significantly greater. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees.

The major shareholders have the same voting rights as the other shareholders.

#### **B. RELATED PARTY TRANSACTIONS**

Pursuant to a distribution agreement we entered into with MailVision Ltd., a company in which we own 26.6% of the shares as of December 31, 2012, we resell and market MailVision's products and services. In 2012, we paid MailVision \$1.4 million pursuant to this distribution agreement. In April 2013, we entered into an asset purchase agreement with MailVision. See "Major Developments since January 1, 2012" under Item 4.A above for a description of the asset purchase agreement. Upon closing of the transaction under this agreement, the distribution agreement with MailVision will be terminated.

#### **C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable.

### **ITEM 8. FINANCIAL INFORMATION**

#### **A. Consolidated Statements and Other Financial Information**

See Item 18.

#### **Legal Proceedings**

For a discussion of our legal proceedings, please see Item 4B-"Information on the Company-Business Overview-Legal Proceedings."

#### **Dividend Policy**

For a discussion of our dividend policy, please see Item 10B-"Additional Information-Memorandum and Articles of Association-Dividends."

B. *Significant Changes*

No significant change has occurred since December 31, 2012, except as otherwise disclosed in this Annual Report.

**ITEM 9. THE OFFER AND LISTING**

A. *OFFER AND LISTING DETAILS UPDATE ALL TABLES AND DISCLOSURE IN THIS SECTION*

Our ordinary shares are listed on the NASDAQ Global Select Market and the TASE under the symbol "AUDC."

The following table sets forth, for the periods indicated, the high and low sales prices of our ordinary shares as reported by the NASDAQ Global Select Market.

Calendar Year	Price Per Share	
	High	Low
2012	\$ 4.25	\$ 1.20
2011	\$ 8.07	\$ 2.28
2010	\$ 6.51	\$ 2.31
2009	\$ 3.06	\$ 0.92
2008	\$ 5.26	\$ 1.47

Calendar Period	Price Per Share	
	High	Low
2013		
Second quarter (through April 3, 2013)	\$ 3.84	\$ 3.02
First quarter	\$ 4.75	\$ 3.20

2012		
Fourth quarter	\$ 3.35	\$ 2.18
Third quarter	\$ 3.20	\$ 1.20
Second quarter	\$ 2.77	\$ 1.70
First quarter	\$ 4.25	\$ 2.58

2011		
Fourth quarter	\$ 3.98	\$ 2.28
Third quarter	\$ 5.75	\$ 2.96
Second quarter	\$ 6.39	\$ 3.93
First quarter	\$ 8.07	\$ 5.38

Calendar Month	Price Per Share	
	High	Low
2013		
March	\$ 4.19	\$ 3.72
February	\$ 4.75	\$ 3.64
January	\$ 3.87	\$ 3.20
2012		
December	\$ 3.35	\$ 2.67
November	\$ 2.82	\$ 2.25
October	\$ 2.77	\$ 2.18
September	\$ 3.20	\$ 1.36

The following table sets forth, for the periods indicated, the high and low sales prices of our ordinary shares as reported by The Tel Aviv Stock Exchange. All share prices shown in the following table are in NIS. As of December 31, 2012, the exchange rate was equal to approximately NIS 3.733 per U.S. \$1.00.

Calendar Year	Price Per Share			
	High		Low	
2012	NIS	15.99	NIS	5.44
2011	NIS	29.51	NIS	8.65
2010	NIS	23.25	NIS	9.20
2009	NIS	11.55	NIS	4.26
2008	NIS	20.20	NIS	5.71

Calendar Period	Price Per Share			
	2013			
Second quarter (through April 3, 2013)	NIS	13.63	NIS	12.97
First quarter	NIS	18.38	NIS	11.37

2012				
Fourth quarter	NIS	12.42	NIS	8.43
Third quarter	NIS	11.49	NIS	5.44
Second quarter	NIS	10.48	NIS	6.60
First quarter	NIS	15.99	NIS	9.85

2011				
Fourth quarter	NIS	14.66	NIS	8.65
Third quarter	NIS	19.03	NIS	11.20
Second quarter	NIS	21.97	NIS	13.63
First quarter	NIS	29.51	NIS	19.14

Calendar Month	Price Per Share			
	High		Low	
2013				
March	NIS	15.49	NIS	13.62
February	NIS	18.38	NIS	14.00
January	NIS	14.05	NIS	11.37
2012				
December	NIS	12.42	NIS	10.25
November	NIS	11.40	NIS	8.71
October	NIS	10.49	NIS	8.43
September	NIS	11.49	NIS	5.55

*B. PLAN OF DISTRIBUTION*

Not applicable.

*C. MARKETS*

Our ordinary shares are listed for trading on the NASDAQ Global Select Market under the symbol "AUDC." Our ordinary shares are also listed for trading on The Tel-Aviv Stock Exchange under the symbol "AUDC." In addition, we are aware of our ordinary shares being traded on the following markets: Frankfurt Stock Exchange, Berlin Stock Exchange, Munich Stock Exchange, Stuttgart Stock Exchange, the German Composite and XETRA.

*D. SELLING SHAREHOLDERS*

Not applicable.

*E. DILUTION*

Not applicable.

*F. EXPENSES OF THE ISSUE*

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

*A. SHARE CAPITAL*

Not applicable.

*B. MEMORANDUM AND ARTICLES OF ASSOCIATION*

**Objects and Purposes**

We were incorporated in 1992 under the laws of the State of Israel. Our registration number with the Israeli Registrar of Companies is 520044132. Our objects and purposes, set forth in Section 2 of our memorandum of association, are:

- to plan, develop and market voice signal systems;
- to purchase, import, market and wholesale and retail distribute, in Israel and abroad, consumption goods and accompanying products;
- to serve as representatives of bodies, entrepreneurs and companies from Israel and abroad with respect to their activities in Israel and abroad; and
- to carry out any activity as determined by the lawful management.

**Share Capital**

Our authorized share capital consists of NIS 1,025,000 divided into 100,000,000 ordinary shares, nominal value NIS 0.01 per share, and 2,500,000 preferred shares, nominal value NIS 0.01 per share. As of April 3, 2013, we had 38,044,692 ordinary shares outstanding (which does not include 11,356,707 treasury shares) and no preferred shares outstanding.

## **Borrowing Powers**

The board of directors has the power to cause us to borrow money and to secure the payment of borrowed money. The board of directors specifically has the power to issue bonds or debentures, and to impose mortgages or other security interests on all or any part of our property.

## **Amendment of Articles of Association**

Shareholders may amend our articles of association by a resolution adopted at a shareholders meeting by the holders of 50% of voting power represented at the meeting in person or by proxy and voting thereon.

## **Dividends**

Under the Israeli Companies Law, we may pay dividends only out of our profits. The amount of any dividend to be distributed among shareholders is based on the nominal value of their shares. Our board of directors has determined that we will not distribute any amounts of our undistributed tax exempt income as dividend. We intend to reinvest our tax-exempt income and not to distribute such income as a dividend. Accordingly, no deferred income taxes have been provided on income attributable to our Approved Enterprise program as the undistributed tax exempt income is essentially permanent in duration.

## **Voting Rights and Powers**

Unless any shares have special rights as to voting, every shareholder has one vote for each share held of record. A shareholder is not entitled to vote at any shareholders meeting unless all calls then payable by him in respect of his shares have been paid (this does not apply to separate meetings of the holders of a particular class of shares with respect to the modification or abrogation of their rights).

Under our articles of association, we may issue preferred shares from time to time, in one or more series. However, in connection with our listing on The Tel-Aviv Stock Exchange in 2001, we agreed that for such time as our ordinary shares are traded on The Tel-Aviv Stock Exchange, we will not issue any of the 2,500,000 preferred shares, nominal value NIS 0.01, authorized in our articles of association. Notwithstanding the foregoing, we may issue preferred shares if the preference of those shares is limited to a preference in the distribution of dividends and such preferred shares have no voting rights.

## **Business Combinations**

Our articles of association impose restrictions on our ability to engage in any merger, asset or share sale or other similar transaction with a shareholder holding 15% or more of our voting shares.

## **Winding Up**

Upon our liquidation, our assets available for distribution to shareholders will be distributed to them in proportion to the nominal value of their shares.

## **Redeemable Shares**

Subject to our undertaking to the Tel-Aviv Stock Exchange as described above, we may issue and redeem redeemable shares.

## **Modification of Rights**

Subject to the provisions of our memorandum of association, and without prejudice to any special rights previously conferred upon the holders of our existing shares, we may, from time to time, by a resolution approved by the holders of 75% voting power represented at the meeting in person or by proxy and voting thereon, provide for shares with such preferred or deferred rights or rights of redemption, or other special rights and/or such restrictions, whether in regard to dividends, voting repayment of share capital or otherwise, as may be stipulated in such resolution.

If at any time our share capital is divided into different classes of shares, we may modify or abrogate the rights attached to any class, unless otherwise provided by the articles of association, by a resolution approved by the holders of 75% voting power represented at the meeting in person or by proxy and voting thereon, subject to the consent in writing of the holders of 75% of the issued shares of that class.

The provisions of our articles of association relating to general meetings also apply to any separate general meeting of the holders of the shares of a particular class, except that two or more members holding not less than 75% of the issued shares of that class must be present in person or by proxy at that separate general meeting for a quorum to exist.

Unless otherwise provided by our articles of association, the increase of an authorized class of shares, or the issuance of additional shares thereof out of the authorized and unissued share capital, shall not be deemed to modify or abrogate the rights attached to previously issued shares of that class or of any other class.

## **Shareholders Meetings**

An annual meeting of shareholders is to be held once a year, within 15 months after the previous annual meeting. The annual meeting may be held in Israel or outside of Israel, as determined by the board of directors.

The board of directors may, whenever it thinks fit, convene a special shareholders meeting. The board of directors must convene a special shareholders meeting at the request of:

- at least two directors;
- at least one-quarter of the directors in office; or
- one or more shareholders who hold at least 5% of the outstanding share capital and at least 1% of the voting rights, or one or more shareholders who hold at least 5% of the outstanding voting rights.

A special shareholders meeting may be held in Israel or outside of Israel, as determined by the board of directors.

## **Notice of General Meetings; Omission to Give Notice**

The provisions of the Companies Law and the related regulations override the provisions of our articles of association, and provide for notice of a meeting of shareholders to be sent to each registered shareholder at least 21 days or 35 days in advance of the meeting depending on the items included in the meeting agenda. Notice of a meeting of shareholders must also be published in two Israeli newspapers at least five days prior to the record date for the meeting.

Notice of a meeting of shareholders must specify the type of meeting, the place and time of the meeting, the agenda, a summary of the proposed resolutions, the majority required to adopt the proposed resolutions, and the record date for the meeting. The notice must also include the address and telephone number of our registered office, and a list of times at which the full text of the proposed resolutions may be examined at the registered office.

The accidental omission to give notice of a meeting to any shareholder, or the non-receipt of notice sent to such shareholder, does not invalidate the proceedings at the meeting.

#### **Limitations on Foreign Shareholders to Hold or Exercise Voting Rights**

There are no limitations on foreign shareholders in our articles of association. Israeli law restricts the ability of citizens of countries that are in a state of war with Israel to hold shares of Israeli companies.

#### **Fiduciary Duties; Approval of Transactions under Israeli Law**

The Companies Law imposes fiduciary duties that “office holders,” including directors and executive officers, owe to their company. An office holder’s fiduciary duties consist of a duty of care and a duty of loyalty.

*Duty of Care.* The duty of care generally requires an office holder to act with the level of care which a reasonable office holder in the same position would have acted under the same circumstances. This includes the duty to use reasonable means to obtain information regarding the advisability of a given action submitted for his or her approval or performed by virtue of his or her position and all other relevant information material to these actions.

*Duty of Loyalty.* The duty of loyalty generally requires an office holder to act in good faith and for the benefit of the company. Specifically, an office holder must avoid any conflict of interest between the office holder’s position in the company and his or her other positions or personal affairs. In addition, an office holder must avoid competing against the company or exploiting any business opportunity of the company for his or her own benefit or the benefit of others. An office holder must also disclose to the company any information or documents relating to the company’s affairs that the office holder has received due to his or her position in the company. A company may approve any of the acts mentioned above provided that all the following conditions apply: the office holder acted in good faith and neither the act nor the approval of the act prejudices the good of the company, and the office holder disclosed the essence of his or her personal interest in the act, including any substantial fact or document, a reasonable time before the date for discussion of the approval. A director is required to exercise independent discretion in fulfilling his or her duties and may not be party to a voting agreement with respect to his or her vote as a director. A violation of these requirements is deemed a breach of the director’s duty of loyalty.

The term “office holder” includes any managing director, general manager, chief executive officer, executive vice president, vice president, or any other person assuming the responsibilities of any of these positions regardless of that person’s title, or any director or any manager directly subordinate to the general manager. Each person listed in the table under Item 6. “Directors, Senior Management and Employees-A. Directors and Senior Management” above is an “office holder” of AudioCodes.

*Disclosure of Personal Interest of Office Holder.* The Companies Law requires that an office holder promptly disclose any personal interest that he or she may have, and all related material information known to him or her, in connection with any existing or proposed transaction by the company. A “personal interest” of an office holder, as defined in the Companies Law, includes a personal interest of the office holder’s relative or a corporation in which the office holder or the office holder’s relative is a 5% or greater shareholder, director or general manager or has the right to appoint at least one director or the general manager, and includes shares for which the person has the right to vote pursuant to a power-of-attorney. “Personal interest” does not apply to a personal interest stemming merely from holding shares in the company.



The office holder must make the disclosure of his personal interest no later than the first meeting of the company's board of directors that discusses the particular transaction. The office holder's duty to disclose shall not apply in the event that the personal interest only results from a personal interest of the office holder's relative in a transaction that is not an "extraordinary transaction." The Companies Law defines an "extraordinary transaction" as a transaction not in the ordinary course of business, not on market terms, or likely to have a material impact on the company's profitability, assets or liabilities, and a "relative" is defined as a spouse, sibling, parent, grandparent, descendant, and includes the descendant, sibling or parent of a spouse, as well as the spouse of any of the foregoing.

*Approval of Compensation of Office Holders.* Under the Companies Law, compensation arrangements for officers (other than the Chief Executive Officer) who are not directors require the approval of the compensation committee and the board of directors. If the compensation arrangement is an immaterial amendment to an existing compensation arrangement of an officer who is not a director, the approval of the compensation committee is sufficient. Arrangements regarding the compensation of the Chief Executive Officer and directors require the approval of the compensation committee, the board and the shareholders, in that order. In certain cases, the compensation of the Chief Executive Officer who is not a director may be approved without approval of the shareholders.

*Approval of Other Transactions with Office Holders.* In the case of a transaction that is not an extraordinary transaction, after the office holder complies with the disclosure requirement described above, only board approval is required unless the articles of association of the company provide otherwise. Our articles of association do not provide otherwise. Such approval must determine that the transaction is not adverse to the company's interest. If the transaction is an extraordinary transaction, or if it concerns exculpation, indemnification, insurance or compensation of an office holder, then the approvals of the company's compensation committee and the board of directors are required, except if the compensation arrangement is a non-material amendment to an existing compensation arrangement of an officer who is not a director (in which case the approval of the compensation committee is sufficient). If the transaction concerns exculpation, indemnification, insurance or compensation of a director, then the approvals of the company's compensation committee, board of directors and shareholders are required (in that order), except if the compensation arrangement is an immaterial amendment to an existing compensation arrangement of an officer who is not a director, in which case the approval of the compensation committee is sufficient. Exculpation, indemnification, insurance or compensation of a director or the Chief Executive Officer also requires shareholder approval.

Any person who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee generally may not be present at such meeting or vote on such matter unless a majority of the board of directors or the audit committee has a personal interest in the matter, or if such person is invited by the chairman of the board of directors or audit committee, as applicable, to present the matter being considered. If a majority of the board of directors or the audit committee has a personal interest in the transaction, shareholder approval also would be required.

*Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders.* Under the Israeli Companies Law, the disclosure requirements described above that apply to an officer holder, also apply to a controlling shareholder of a public company, which includes a shareholder that holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Two or more shareholders with a personal interest in the approval of the same transaction are deemed to be one shareholder for this purpose. Approval of the audit committee, the board of directors and our shareholders, in that order, is required for extraordinary transactions, including a private placement, with a controlling shareholder or in which a controlling shareholder has a personal interest.

Approval of the compensation committee, the board of directors and our shareholders, in that order, is required for the terms of compensation or employment of a controlling shareholder or his or her relative, as an officer holder or employee of our company or as a service provider to the company, including through a company controlled by a controlling shareholder.

The shareholders approval must include the majority of shares voted at the meeting. In addition to the majority vote, the shareholder approval must satisfy either of two additional tests:

- the majority includes at least a majority of the shares voted by shareholders who have no personal interest in the transaction; or
- the total number of shares held by the disinterested shareholders that voted against the approval of the transaction does not exceed 2% of the aggregate voting rights of our company.

Generally, the approval of such a transaction may not be for more than three years. However, an extraordinary transaction, including a private placement with a controlling shareholder or in which a controlling shareholder has a personal interest that does not concern the terms of compensation or employment or engagement of a controlling shareholder or his or her relative, as an officer holder or employee of our company or as a service provider to the company, the transaction may be approved for a longer period if the audit committee determines that the approval of the transaction for a period of longer than three years is reasonable under the circumstances.

*Duties of Shareholders.* Under the Israeli Companies Law, a shareholder also has a duty to act in good faith towards the company and other shareholders and refrain from abusing his or her power in the company, including, among other things, voting in the general meeting of shareholders on the following matters:

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of related party transactions that require shareholder approval.

In addition, any controlling shareholder, any shareholder who can determine the outcome of a shareholder vote and any shareholder who, under the company's articles of association, can appoint or prevent the appointment of an office holder, is under a duty to act with fairness towards the company. The Israeli Companies Law also provides that a breach of the duty of fairness will be governed by the laws governing breach of contract; however, the Israeli Companies Law does not describe the substance of this duty.

#### **Anti-Takeover Provisions Under Israeli Law**

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 hold 25% or more of the voting rights in the company, unless there is already another shareholder of the company with 25% or more of the voting rights. 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 hold more than 45% of the voting rights in the company, unless there is a shareholder with more than 45% of the voting rights in the company.

The Companies Law requires the parties to a proposed merger to file a merger proposal with the Israeli Registrar of Companies, specifying certain terms of the transaction. Each merging company's board of directors and shareholders must approve the merger. Shares in one of the merging companies held by the other merging company or certain of its affiliates are disenfranchised for purposes of voting on the merger. A merging company must inform its creditors of the proposed merger. Any creditor of a party to the merger may seek a court order blocking the merger, if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of the parties to the merger. Moreover, a merger may not be completed until at least 50 days have passed from the time that the merger proposal was filed with the Israeli Registrar of Companies and at least 30 days have passed from the approval of the shareholders of each of the merging companies.

Finally, in general, Israeli tax law treats stock-for-stock acquisitions less favorably than does U.S. tax law. Israeli tax law provides for tax deferral in specified acquisitions, including transactions where the consideration for the sale of shares is the receipt of shares of the acquiring company. Nevertheless, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in a foreign corporation to immediate taxation or to taxation before his investment in the foreign corporation becomes liquid, although in the case of shares of a foreign corporation that are traded on a stock exchange, the tax may be postponed subject to certain conditions.

## **Insurance, Indemnification and Exculpation of Directors and Officers; Limitations on Liability**

### *Insurance of Office Holders*

The Companies Law permits a company, if permitted by its articles of association, to insure an office holder in respect of liabilities incurred by the office holder as a result of:

- breach of the duty of care owed to the company or a third party;
- breach of the fiduciary duty owed to the company, provided that the office holder acted in good faith and had reasonable grounds to believe that his action would not harm the company's interests;
- monetary liability imposed on the office holder in favor of a third party; and
- reasonable litigation expenses, including attorney fees, incurred by the office holder as a result of an administrative enforcement proceeding instituted against him (without limiting from the generality of the foregoing, such expenses will include a payment imposed on the office holder in favor of an injured party as set forth in Section 52(54)(a)(1)(a) of the Israel Securities Law, 5728-1968, as amended (the "Israeli Securities Law"), and expenses that the office holder incurred in connection with a proceeding under Chapters H'3, H'4 or I'1 of the Israeli Securities Law, including reasonable legal expenses, which term includes attorney fees).

### *Indemnification of Office Holders*

Under the Companies Law, a company can, if permitted by its articles of association, indemnify an office holder for any of the following obligations or expenses incurred in connection with his or her acts or omissions as an office holder:

- monetary liability imposed on an office holder in favor of a third party in a judgment, including a settlement or an arbitral award confirmed by a court;
- reasonable legal costs, including attorney's fees, expended by an office holder as a result of:
  - an investigation or proceeding instituted against the office holder by a competent authority, provided that such investigation or proceeding concludes without the filing of an indictment against the office holder, and either:
    - o no financial liability was imposed on the office holder in lieu of criminal proceedings, or

- o financial liability was imposed on the office holder in lieu of criminal proceedings but the alleged criminal offense does not require proof of criminal intent; and (y) in connection with an administrative enforcement proceeding or a financial sanction (without derogating from the generality of the foregoing, such expenses will include a payment imposed on the Office Holder in favor of an injured party as set forth in Section 52(54)(a)(1)(a) of the Israeli Securities Law, and expenses that the Office Holder incurred in connection with a proceeding under Chapters H'3, H'4 or I'1 of the Israeli Securities Law, including reasonable legal expenses, which term includes attorney fees); and
- reasonable legal costs, including attorneys' fees, expended by the office holder or for which the office holder is charged by a court:
  - in an action brought against the office holder by or on behalf of the company or a third party, or
  - in a criminal action in which the office holder is found innocent, or
  - in a criminal action in which the office holder is convicted and in which a proof of criminal intent is not required.
- o A company may indemnify an office holder in respect of these liabilities either in advance of an event or following an event. If a company undertakes to indemnify an office holder in advance of an event, the indemnification, other than legal costs, must be limited to foreseeable events in light of the company's actual activities when the company undertook such indemnification, and reasonable amounts or standards, as determined by the board of directors.

#### *Exculpation of Office Holders*

Under the Companies Law, a company may, if permitted by its articles of association, also exculpate an office holder in advance, in whole or in part, from liability for damages sustained by a breach of duty of care to the company, other than in connection with distributions.

#### *Limitations on Exculpation, Insurance and Indemnification*

Under the Companies Law, a company may indemnify or insure an office holder against a breach of duty of loyalty only to the extent that the office holder acted in good faith and had reasonable grounds to assume that the action would not prejudice the company. In addition, a company may not indemnify, insure or exculpate an office holder against a breach of duty of care if committed intentionally or recklessly (excluding mere negligence), or committed with the intent to derive an unlawful personal gain, or for a fine or forfeit levied against the office holder in connection with a criminal offense.

Our articles of association allow us to insure, indemnify and exculpate office holders to the fullest extent permitted by law, provided such insurance or indemnification is approved in accordance with law. Pursuant to the Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and our board of directors and, if the office holder is a director, also by our shareholders.

We have entered into agreements with each of our directors and senior officers to insure, indemnify and exculpate them to the full extent permitted by law against some types of claims, subject to dollar limits and other limitations. These agreements have been ratified by our audit committee, board of directors and shareholders. We have acquired directors' and officers' liability insurance covering our officers and directors and the officers and directors of our subsidiaries against certain claims.

### C. MATERIAL CONTRACTS

In September 2011, we entered into loan agreements with First International Bank of Israel that provided for loans in the total principal amount of \$6.75 million. The Loans bear interest at LIBOR+2.1% with respect to one-half of the principal amount of the loans and LIBOR plus 3.1% with respect to the other half of the principal amount of the loan. The principal amount borrowed is repayable in 20 equal quarterly installments from September 2012 through September 2017. The bank has a lien on our assets and we are required to maintain compensating balances with the bank equal to 50% of the principal amount of the loan, plus an additional \$1 million in connection with a waiver granted by the bank that is described below. The additional \$1 million of compensating balances is to stay in place until such time as we are in compliance with the original covenants. The agreement requires us, among other things, to maintain shareholders' equity, cash balance and liabilities to banks at specified levels and to achieve certain levels of operating income. The agreement also restricts us from paying dividends.

In September 2011, we entered into loan agreements with Bank Leumi in Israel that provided for loans in the total amount of \$12.0 million. The loans bear interest at LIBOR plus 3.4% with respect to one-half of the principal amount of the loans and LIBOR plus 2.75% with respect to the other half of the loans. According to the loan agreement we are required to maintain compensating balances as a bank deposit in an amount equal to 50% of the principal amount of the loan, plus an additional \$1 million in connection with a waiver granted by the bank that is described below. The additional \$1 million of compensating balances is to stay in place until such time as we are in compliance with the original covenants. This bank deposit bears interest at LIBOR plus 2.38%. The principal amount borrowed is repayable in 20 equal quarterly installments from December 2011 through September 2017.

In December 2011, we entered into loan agreements with bank Mizrahi in Israel that provided for loans in the total amount of \$5.0 million. The loans bear interest at LIBOR plus 3.6% with respect to \$1.1 million of the loans. According to the loan agreement, we are required to maintain a \$3.9 million compensating balance as a bank deposit, subject to reduction as this portion of the loan is repaid. This \$3.9 million portion of the loan bears interest at 0.5% above the bank deposit interest rate. Of the amount borrowed, \$1.1 million is repayable in 20 equal quarterly installments and the remaining \$3.9 million is repayable in 10 equal semiannual payments through December 2016.

As of December 31, 2012, the Bank Mizrahi loans bear interest at LIBOR plus 4.35% with respect to \$935,000 of the loans. According to the loan agreement, we are required to maintain a \$3.1 million compensating balance as a bank deposit. This \$3.1 million portion of the loan bears interest at 1.25% above the bank deposit interest rate and reduces the compensating balance as it is repaid.

The other terms of the loan with Bank Leumi and Bank Mizrahi are similar to the loan agreement with First International Bank described in the first paragraph of this section. Bank Leumi, Bank Mizrahi and First International Bank share the lien on our assets.

During 2012, we were not in compliance with some of the financial covenants contained in our loan agreements. Each of Bank Leumi, Bank Mizrahi and First International Bank agreed to waive compliance with these covenants, subject to compliance with revised financial covenants during the remainder of 2012 and 2013, an increase in the interest rate with respect to one of the loans and an increase in required compensating balances. As of December 31, 2012, we were in compliance with the covenants in our loan agreements. If we are unable to comply with our revised financial covenants, our lenders could require us to repay all of our outstanding loans.

#### D. EXCHANGE CONTROLS

Non-residents of Israel who own our ordinary shares may freely convert all amounts received in Israeli currency in respect of such ordinary shares, whether as a dividend, liquidation distribution or as proceeds from the sale of the ordinary shares, into freely-repatriable non-Israeli currencies at the rate of exchange prevailing at the time of conversion (provided in each case that the applicable Israeli income tax, if any, is paid or withheld).

Since January 1, 2003, all exchange control restrictions on transactions in foreign currency in Israel have been eliminated, although there are still reporting requirements for foreign currency transactions. Legislation remains in effect, however, pursuant to which currency controls may be imposed by administrative action at any time.

The State of Israel does not restrict in any way the ownership or voting of our ordinary shares by non-residents of Israel, except with respect to subjects of countries that are in a state of war with Israel.

#### E. TAXATION

The following is a summary of the material Israeli and United States federal tax consequences, Israeli foreign exchange regulations and certain Israeli government programs affecting us. To the extent that the discussion is based on new tax or other legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax or other authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice, is not exhaustive of all possible tax considerations and should not be relied upon for tax planning purposes. Potential investors are urged to consult their own tax advisors as to the Israeli tax, United States federal income tax and other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

##### *Israeli Tax Considerations*

##### **General Corporate Tax Structure**

Generally, Israeli companies are subject to corporate tax on taxable income at the rate of 25% for the 2012 tax year. The corporate tax rate applicable for 2011 was 24% and for 2010 was 25%.

On December 5, 2011, the Israeli Parliament enacted the Law for Tax Burden Reform (Legislative Amendments), 2011 (the "Law") which, among other things, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

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

Our facilities have been granted approved enterprise status pursuant to the Law for the Encouragement of Capital Investments, 1959 or the Investment Law, which provides certain tax and financial benefits to investment programs that have been granted such status.

The Investment Law provides that a proposed capital investment in eligible facilities may be designated as an "approved enterprise." Until 2005, the designation required advance approval from the Investment Center of the Israel Ministry of Industry, Trade and Labor (the Investment Center). Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program. The tax benefits under the Investment Law are not available for income derived from products manufactured outside of Israel.

A company owning an approved enterprise may elect to receive either governmental grants or an alternative package of tax benefits. Under the alternative package, a company's undistributed income derived from an approved enterprise will be exempt from corporate tax for a period of two to ten years (depending on the geographic location of the approved enterprise within Israel). The exemption commences in the first year of taxable income, and the company is taxed at a reduced corporate rate of 10% to 25% for the following five to eight years, depending on the extent of foreign shareholders' ownership of the company's ordinary shares. The benefits period is limited to twelve years from completion of the investment under the approved plan or fourteen years from the date of approval, whichever is earlier (these limits do not apply to the exemption period). A Foreign Investors Company, or FIC, defined in the Investment Law as a company of which more than 25% of its shareholders are non-Israeli residents, may enjoy benefits for a period of up to ten years, or twelve years if it complies with certain export criteria stipulated in the Investment Law (the actual length of the benefits period is graduated based on the percentage of foreign ownership).

We have elected the alternative package of tax exemptions and reduced tax rates for our production facilities that have received Approved Enterprise status. Accordingly, income derived from these facilities is generally entitled to a tax-exemption period of two years and a reduced corporate tax rate of 10% to 25% for an additional period of five to eight years, based on our percentage of foreign investment.

If we fail to meet the requirements of an Approved Enterprise we would be subject to corporate tax in Israel at the regular statutory rate. We could also be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

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 are approved, its effective tax rate is the result of a weighted combination of the applicable rates.

Our production facilities have been granted the status of approved enterprise. Income arising from our approved enterprise facilities is tax-free under the alternative package of benefits described above and entitled to reduced tax rates based on the level of foreign ownership for specified periods. We have derived, and expect to continue to derive, a substantial portion of our operating income from our approved enterprise facilities.

Distribution of earnings derived from approved enterprise which were previously taxed at reduced tax rates, would not result in additional tax consequences to us. However, if retained tax-exempt income is distributed in a manner, we would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%). We are not obliged to distribute exempt retained earnings under the alternative package of benefits, and may generally decide from which source of income to declare dividends. We currently intend to reinvest the amount of our tax-exempt income and not to distribute such income as a dividend. Dividends from approved enterprises are generally taxed at a rate of 15% (which is withheld and paid by the company paying the dividend) if such dividend is distributed during the benefits period or within twelve years thereafter. The twelve-year limitation does not apply to an FIC.

In addition, the benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investment Law and related regulations and the criteria set forth in the specific certificate of approval. In the event that a company does not meet these conditions, it will be subject to corporate tax at the rate then in effect under Israeli law for such tax year. As of December 31, 2012, management believes that we meet all of the aforementioned conditions.

On April 1, 2005, an amendment to the law came into effect (the “2005 Amendment”) and has significantly changed the provisions of the law. The 2005 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 Privileged Enterprise’s income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment in the Beneficiary 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 Beneficiary Enterprise, or the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Beneficiary Enterprise and the company’s effective tax rate will be the result of a weighted average of the applicable rates. In this case, the minimum investment required in order to qualify as a Beneficiary Enterprise is required to exceed a certain percentage or a minimum amount of the company’s production assets at the end of the year before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the Commencement Year, or twelve years from the first day of the Year of Election. The Commencement Year is defined as the later of (a) the first tax year in which a company had derived income for tax purposes from the Beneficiary Enterprise or (b) the year in which a company requested to have the tax benefits apply to the Beneficiary Enterprise - Year of Election. The tax benefits granted to a Beneficiary 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 Beneficiary 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 Beneficiary Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) in respect of the gross amount of the dividend that we may be distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Beneficiary 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 Beneficiary Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

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

The 2005 Amendment changed the definition of “foreign investment” in the Investments Law so that the definition 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 aforementioned definition will take effect retroactively from 2003.



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

In addition, the law provides that terms and benefits included in any certificate of approval granted prior to December 31, 2004 will remain subject to the provisions of the law as they were on the date of such approval. Therefore, our existing Approved Enterprises" will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the law as amended, will subject us to taxes upon distribution or liquidation and we may be required to record a deferred tax liability with respect to such tax-exempt income. We elected 2008 and 2011 as "year of election" under the Investments Law after the Amendment. We expect that a substantial portion of any taxable operating income that we may realize in the future will be derived from our approved enterprise status.

In December 2010, an amendment to the Investment Law came into effect ("the 2010 Amendment"). The 2010 Amendment became effective as of January 1, 2011. According to the 2010 Amendment, the benefit tracks in the Investment Law were modified and a flat tax rate applies to the our entire preferred income. We can elect to have the 2010 Amendment apply to it. Once an election is made, we will be subject to the amended tax rates as follows: 2011 and 2012 - 15%, 2013 and 2014 - 12.5% and in 2015 and thereafter - 12%.

We do not currently intend to implement the 2010 Amendment, and intend to continue to comply with the Investment Law as in effect prior to enactment of the 2010 Amendment until the earlier of such time that compliance with the Investment Law prior to 2010 Amendment is no longer in our interests or until the expiration of our current investment programs. We are required to comply with the 2010 Amendment subsequent to the expiration of our current investment programs and for any new qualified investment program, after a transitional period. As a result, the 2010 Amendment may increase our average tax rate in future years.

Recently, new legislation amending the law was adopted. Under this new legislation, a uniform corporate tax rate will apply to all qualifying income of certain industrial companies, as opposed to the current law's incentives, which are limited to income from Approved Enterprises and Privileged Enterprises during their benefits period. Under the new law, the uniform tax rate will be 10% in areas in Israel designated as Development Zone A and 15% elsewhere in Israel during 2011-2012, 7% in Development Zone A and 12.5% elsewhere in Israel in 2013-2014, and 6% in Development Zone A and 12% elsewhere in Israel thereafter. The profits of these industrial companies will be freely distributable as dividends, subject to a 15% withholding tax (or lower, under an applicable tax treaty). AudioCodes is not located in Zone A.

Under the transition provisions of the new legislation, we may decide to irrevocably implement the new law during 2012-2013 while waiving benefits provided under the current law or to remain subject to the current law.

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

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

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

#### **Law for the Encouragement of Industrial Research and Development, 1984**

Under the Law for the Encouragement of Industrial Research and Development, 1984 and the related regulations, or the Research Law, research, development and pre-manufacturing programs that meet specified criteria and are approved by a governmental committee (the Research Committee) of the Office of Chief Scientist (OCS) are eligible for grants of up to 50% of the expenditures on the program. Each application to the OCS is reviewed separately, and grants are based on the program approved by the Research Committee. Expenditures supported under other incentive programs are not eligible for OCS grants. As a result, we cannot be sure that applications to the OCS will be approved or, if approved, that we will receive the amounts for which we apply.

Recipients of these grants are required to pay royalties on the revenues derived from the sale of product developed in accordance with the program. The royalties are payable at the rate of 3% to 6% of revenues, with the total royalties not to exceed 100% of the dollar value of the OCS grant.

The terms of the Israeli government participation require that products developed with OCS grants must generally be manufactured in Israel. If we receive OCS approval for any portion of this manufacturing to be performed outside of Israel, the royalty rate would be increased and the repayment schedule would be accelerated, based on the extent of the manufacturing conducted outside of Israel. Depending upon the extent of the manufacturing volume that is performed outside of Israel, the ceiling on royalties would increase to 120%, 150% or 300% of the grant. Under an amendment to the Research Law effective since 2003, the authority of the Research Committee to approve the transfer of manufacture outside of Israel was expanded.

The technology developed pursuant to the terms of these grants may not be transferred to third parties without the prior approval of the Research Committee. This approval is required only for the export of the technology, and not for the export of any products that incorporate the sponsored technology. Approval of the transfer of technology may be granted only if the recipient agrees to abide by all the provisions of the Research Law, including the restrictions on the transfer of know-how and the obligation to pay royalties in an amount that may be increased. The 2005 amendment to the Research Law granted authority to the Research Committee to approve the transfer of sponsored technology outside of Israel, subject to various conditions.

We have received grants from the OCS, and therefore we are subject to various restrictions under the Research Law on the transfer of technology or manufacturing. These restrictions do not terminate upon the full payment of royalties.

In order to meet specified conditions in connection with the grants and programs of the OCS, we have made representations to the Government of Israel about our Israeli operations. From time to time the conduct of our Israeli operations has deviated from our representations. If we fail to meet the conditions to grants, including the maintenance of a material presence in Israel, or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund the grants previously received (together with an adjustment based on the Israeli consumer price index and an interest factor) and would likely be ineligible to receive OCS grants in the future.

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

According to the Law for the Encouragement of Industry (Taxation), 1969, or the Industry Encouragement Law, an “industrial company” is a company resident in Israel, that at least 90% of its income, in any tax year (determined in Israeli currency, exclusive of income from certain 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. We currently believe that we qualify as an industrial company within the definition of the Industry Encouragement Law. Under the Industry Encouragement Law, industrial companies are entitled to the following preferred corporate tax benefits:

- deduction of purchases of know-how and patents over an eight-year period for tax purposes;
- the right to elect, under specified conditions, to file a consolidated tax return with related Israeli industrial companies;
- accelerated depreciation rates on equipment and buildings; and
- deductions over a three-year period of expenses involved with the issuance and listing of shares on the Tel Aviv Stock Exchange or, on or after January 1, 2003, on a recognized stock market outside of Israel.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. The Israeli tax authorities may determine that we do not qualify as an industrial company, which would entail our loss of the benefits that relate to this status. In addition, no assurance can be given that we will continue to qualify as an industrial company, in which case the benefits described above will not be available in the future.

#### **Israeli Transfer Pricing Regulations**

On November 29, 2006, Income tax regulation (Determination of Market Terms), 2006, promulgated under Section 85A of the Israeli Tax Ordinance, came into force (the “Transfer Pricing Regulations”). Section 85A of the Israeli Tax Ordinance and the Transfer Pricing Regulations generally require that all cross-border transactions carried out between related parties will be conducted on an arm’s length basis and will be taxed accordingly.

## **Special Provisions Relating to Measurement of Taxable Income**

We 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. Accordingly, commencing taxable year 2003, results for tax purposes are measured in terms of earnings in dollars.

### **Capital Gains Tax**

Israeli law generally imposes a capital gains tax on the sale of securities of an Israeli company traded on the TASE, on an authorized stock exchange outside Israel or on a regulated market (which includes a system through which securities are traded pursuant to rules prescribed by the competent authority in the relevant jurisdiction) in or outside Israel. Pursuant to amendments to the Tax Ordinance, effective as of January 1, 2012, the capital gains tax rate applicable to individuals upon the sale of such securities is such individual's marginal tax rate but not more than 25% (or 30% with respect to a Substantial Shareholder). A 30% tax rate will apply to an individual who meets the definition of a 'Substantial Shareholder' on the date of the sale of the securities or at any time during the 12 months preceding such date. A 'Substantial Shareholder' is defined as a person who, either alone or together with any other person, holds, directly or indirectly, at least 10% of any of the means of control of a company (including, among other things, the right to receive profits of the company, voting rights, the right to receive the company's liquidation proceeds and the right to appoint a director). Different tax rates apply to capital gains accrued from the sale by individuals of securities that are not publicly traded as aforesaid.

With respect to corporate investors, effective January 1, 2012, capital gain tax equal to the corporate tax rate (as of January 1, 2012 - 25%) will be imposed on the sale of traded shares.

These rates are subject to the provisions of any applicable bilateral double taxation treaty. The treaty concerning double taxation between the United States and Israel (the Convention between the Government of the State of Israel and the Government of the United States of America With Respect to Taxes on Income (the "Treaty")) is discussed below.

In addition, if our ordinary shares are traded on the TASE, on an authorized stock exchange outside Israel or on a regulated market (which includes a system through which securities are traded pursuant to rules prescribed by the competent authority in the relevant jurisdiction) in or outside Israel, gains on the sale of our ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax. Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income. In addition, persons paying consideration for shares, including purchasers of shares, Israeli securities dealers effecting a transaction, or a financial institution through which securities being sold are held, are required, subject to any applicable exemptions and the demonstration of the selling shareholder of its non-Israeli residency, to withhold tax upon the sale of publicly traded securities at a rate of 25% for a corporation and 25% for an individual.

Israeli law generally exempts non-resident individuals and entities from capital gains tax on the sale of securities of Israeli companies, provided that the securities were acquired on or after January 1, 2009.

### **Income Taxes on Dividend Distribution to Non-Israeli Shareholders**

Non-Israeli residents (whether individuals or corporations) are generally subject to Israeli income tax on the receipt of dividends paid on the shares of companies that are not publicly traded at the rate of 25% (30% if the dividend recipient is a Substantial Shareholder, at the time of distribution or at any time during the preceding 12-month period), which tax is to be withheld at source, unless a different rate is provided under an applicable tax treaty. Dividends paid on the shares of companies that are publicly traded, like our ordinary shares, to non-Israeli residents, although generally subject to the same tax rates applicable to dividends paid on the shares of companies that are not publicly traded, are generally subject to Israeli withholding tax at a rate of 25% (whether or not the recipient is a Substantial Shareholder), unless a different rate is provided under an applicable tax treaty. The distribution of dividends to non-Israeli residents (either individuals or corporations) from income derived from an Approved Enterprise or a Benefiting Enterprise during the applicable benefits period or from Preferred Income is subject to withholding tax at a rate of 15%, unless a different tax rate is provided under an applicable tax treaty.

A non-resident of Israel who has dividend income derived from or accrued in Israel, from which the full amount of tax was withheld at source, is generally exempt from the duty to file tax returns in Israel in respect of such income, provided that: (i) such income was not derived from a business conducted in Israel by the taxpayer; and (ii) the taxpayer has no other taxable sources of income in Israel with respect to which a tax return is required to be filed.

Residents of the United States generally will have withholding tax in Israel deducted at source. As discussed below, they may be entitled to a credit or deduction for U.S. federal income tax purposes in the amount of the taxes withheld, subject to detailed rules contained in U.S. tax legislation.

### **Tax Benefits of Research and Development**

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

- The expenditures are approved by the relevant Israeli government ministry, determined by the field of research;
- The research and development 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.

Expenditures not so approved are deductible over a three-year period. However, expenditures made out of proceeds made available to a company through government grants are not deductible according to Israeli law.

### **United States-Israel Tax Treaty**

Pursuant to the Convention Between the Government of the United States of America and the Government of Israel with respect to Taxes on Income, as amended, or the United States-Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who holds the ordinary shares as a capital asset and who qualifies as a resident of the United States within the meaning of the United States-Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the United States-Israel Tax Treaty, or a Treaty United States Resident, generally will not be subject to the Israeli capital gains tax unless such Treaty United States Resident holds, directly or indirectly, shares representing 10% or more of the voting power of our company during any part of the twelve-month period preceding such sale, exchange or disposition, subject to certain conditions. A sale, exchange or disposition of shares by a Treaty United States Resident who holds, directly or indirectly, shares representing 10% or more of the voting power of our company at any time during such preceding twelve-month period would be subject to such Israeli tax, to the extent applicable; however, under the United States-Israel Tax Treaty, such Treaty United States Resident would be permitted to claim a credit for such taxes against the United States federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in United States laws applicable to foreign tax credits. The United States-Israel Tax Treaty does not relate to state or local taxes.

## **Tax on Dividends**

Non-residents of Israel are subject to Israeli income tax on income accrued or derived from sources in Israel or received in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. Generally, on distributions of dividends, other than bonus shares and stock dividends, income tax at the rate of 25% is withheld at the source (except that dividends distributed on or after January 1, 2006 to an individual who is deemed a “non-substantial shareholder” are subject to tax at the rate of 20%), unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty United States Resident will be 25%, however that tax rate is reduced to 12.5% for dividends not generated by an approved enterprise to a corporation which holds 10% or more of the voting power of our company during a certain period preceding distribution of the dividend. Dividends derived from an approved enterprise will still be subject to 15% tax withholding.

## **Foreign Exchange Regulations**

Dividends, if any, paid to the holders of the ordinary shares, and any amounts payable upon dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of the ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid or withheld on such amounts.

## **United States Tax Considerations**

The following summary describes the material U.S. federal income tax consequences to “U.S. Holders” (as defined below) arising from the acquisition, ownership and disposition of our ordinary shares. This summary is based on the Internal Revenue Code of 1986, as amended, or the “Code,” the final, temporary and proposed U.S. Treasury Regulations promulgated thereunder and administrative and judicial interpretations thereof, all as of the date hereof and all of which are subject to change (possibly with retroactive effect) or different interpretations. For purposes of this summary, a “U.S. Holder” will be deemed to refer only to any of the following holders of our ordinary shares:

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

This summary does not consider all aspects of U.S. federal income taxation that may be relevant to particular U.S. Holders by reason of their particular circumstances, including potential application of the U.S. federal alternative minimum tax, or any aspect of state, local or non-U.S. federal tax laws or U.S. federal tax laws other than U.S. federal income tax laws. In addition, this summary is directed only to U.S. Holders that hold our ordinary shares as “capital assets” within the meaning of Section 1221 of the Code and does not address the considerations that may be applicable to particular classes of U.S. Holders, including financial institutions, regulated investment companies, real estate investment trusts, pension funds, insurance companies, broker-dealers, tax-exempt organizations, grantor trusts, partnerships or other pass-through entities, partners or other equity holders in partnerships or other pass-through entities, holders whose functional currency is not the U.S. dollar, holders who have elected mark-to-market accounting, holders who acquired our ordinary shares through the exercise of options or otherwise as compensation, holders who hold our ordinary shares as part of a “straddle,” “hedge” or “conversion transaction,” holders selling our ordinary shares short, holders deemed to have sold our ordinary shares in a “constructive sale,” and holders, directly, indirectly or through attribution, of 10% or more (by vote or value) of our outstanding ordinary shares.

**Each U.S. Holder should consult with its own tax advisor as to the particular tax consequences to it of the acquisition, ownership and disposition of our ordinary shares, including the effects of applicable tax treaties, state, local, foreign or other tax laws and possible changes in the tax laws.**

#### **Distributions With Respect to Our Ordinary Shares**

For U.S. federal income tax purposes, the amount of a distribution with respect to our ordinary shares will equal the amount of cash distributed, the fair market value of any property distributed and the amount of any Israeli taxes withheld on such distribution as described above under “Israeli Tax Considerations - Tax on Dividends.” Other than distributions in liquidation or in redemption of our ordinary shares that are treated as exchanges, a distribution with respect to our ordinary shares to a U.S. Holder generally will be treated as a dividend to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of any distribution that exceeds these earnings and profits will be treated first as a non-taxable return of capital, reducing the U.S. Holder’s tax basis in its ordinary shares (but not below zero), and then generally as capital gain from a deemed sale or exchange of such ordinary shares. Corporate U.S. Holders generally will not be allowed a deduction under Section 243 of the Code for dividends received on our ordinary shares and thus will be subject to tax at the rate applicable to their taxable income. A noncorporate U.S. Holder’s “qualified dividend income” generally is subject to tax at a rate of 15% for tax years beginning before 2013 and 20% for tax years beginning after 2012. For this purpose, “qualified dividend income” generally includes dividends paid by a foreign corporation if, among other things, the noncorporate U.S. Holder meets certain minimum holding period requirements and either (a) the stock of such corporation is readily tradable on an established securities market in the U.S., including the NASDAQ Global Select Market, or (b) such corporation is eligible for the benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The U.S. Secretary of the Treasury has indicated that the income tax treaty between the U.S. and Israel is satisfactory for this purpose. Dividends paid by us will not qualify for the 15% (through 2012) or 20% (after 2012) U.S. federal income tax rate, however, if we are treated, for the tax year in which the dividends are paid or the preceding tax year, as a “passive foreign investment company” for U.S. federal income tax purposes. See the discussion below under the heading “Passive Foreign Investment Company Status.” For tax years beginning after 2012, a noncorporate U.S. Holder may be subject to an additional tax based on its “net investment income” (generally, gross income from interest, dividends, annuities, royalties and rents and gain from the sale of property (other than property held in the active conduct of a trade or business that does not regularly trade financial instruments or commodities), less the amount of deductions properly allocable to such income or gain). Such tax is equal to 3.8% of the lesser of an individual U.S. Holder’s (i) net investment income, or (ii) the excess of such U.S. Holder’s “modified adjusted gross income” (adjusted gross income plus the amount of any foreign earned income excluded from income under Section 911(a)(1) of the Code, net of deductions and exclusions disallowed with respect to such foreign earned income) over a specified threshold amount (\$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return and \$200,000 in any other case). In the case of a U.S. Holder which is an estate or trust, the tax is equal to 3.8% of the lesser of (i) undistributed net investment income, or (ii) the excess of adjusted gross income (as defined in Section 67(e) of the Code) over the dollar amount at which the highest tax bracket applicable to an estate or trust begins.

**U.S. Holders are urged to consult their own tax advisors regarding the U.S. federal income tax consequences of their receipt of any distributions with respect to our ordinary shares.**

A dividend paid by us in NIS will be included in the income of U.S. Holders at the U.S. dollar amount of the dividend, based on the “spot rate” of exchange in effect on the date of receipt or deemed receipt of the dividend, regardless of whether the payment is in fact converted into U.S. dollars. U.S. Holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that U.S. dollar value. Any gain or loss upon the subsequent conversion of the NIS into U.S. dollars or other disposition of the NIS will constitute foreign currency gain or loss taxable as ordinary income or loss and will be treated as U.S.-source income or loss for U.S. foreign tax credit purposes.

Dividends received with respect to our ordinary shares will constitute “portfolio income” for purposes of the limitation on the deductibility of passive activity losses and, therefore, generally may not be offset by passive activity losses. Dividends received with respect to our ordinary shares also generally will be treated as “investment income” for purposes of the investment interest deduction limitation contained in Section 163(d) of the Code, and as foreign-source passive income for U.S. foreign tax credit purposes or, in the case of a U.S. Holder that is a financial services entity, financial services income. Subject to certain limitations, U.S. Holders may elect to claim as a foreign tax credit against their U.S. federal income tax liability any Israeli income tax withheld from distributions with respect to our ordinary shares which constitute dividends under U.S. income tax law. A U.S. Holder that does not elect to claim a foreign tax credit may instead claim a deduction for Israeli income tax withheld, but only if the U.S. Holder elects to do so with respect to all foreign income taxes in such year. In addition, special rules may apply to the computation of foreign tax credits relating to “qualified dividend income,” as defined above. The calculation of foreign tax credits and, in the case of a U.S. Holder that elects to deduct foreign income taxes, the availability of deductions involve the application of complex rules that depend on a U.S. Holder’s particular circumstances. U.S. Holders are urged to consult their own tax advisors regarding the availability to them of foreign tax credits or deductions in respect of any Israeli tax withheld or paid with respect to any dividends which may be paid with respect to our ordinary shares.

### **Disposition of Our Ordinary Shares**

Subject to the discussion below under “Passive Foreign Investment Company Status,” a U.S. Holder’s sale, exchange or other taxable disposition of our ordinary shares generally will result in the recognition by such U.S. Holder of capital gain or loss in an amount equal to the difference between the U.S. dollar value of the amount realized and the U.S. Holder’s tax basis in the ordinary shares disposed of (measured in U.S. dollars). This gain or loss will be long-term capital gain or loss if such ordinary shares have been held or are deemed to have been held for more than one year at the time of the disposition. Individual U.S. Holders are subject to a maximum tax rate of 15% (for tax years beginning before 2013) or 20% (for tax years beginning after 2012) on long-term capital gains, and for tax years beginning after 2012, also may be subject to the additional tax on “net investment income” described above in “Distributions With Respect to Our Ordinary Shares.” If the U.S. Holder’s holding period on the date of the taxable disposition is one year or less, such gain or loss will be a short-term capital gain or loss. Short-term capital gains generally are taxed at the same rates applicable to ordinary income. See “Israeli Tax Considerations - Capital Gains Tax” for a discussion of taxation by Israel of capital gains realized on sales of our ordinary shares. Any capital loss realized upon the taxable disposition of our ordinary shares generally will be deductible only against capital gains and not against ordinary income, except that noncorporate U.S. Holders generally may deduct annually from ordinary income up to \$3,000 of net capital losses. In general, any capital gain or loss recognized by a U.S. Holder upon the taxable disposition of our ordinary shares will be treated as U.S.-source income or loss for U.S. foreign tax credit purposes, although the tax treaty between the United States and Israel may permit gain derived from the taxable disposition of ordinary shares by a U.S. Holder to be treated as foreign-source income for U.S. foreign tax credit purposes under certain circumstances.

A U.S. Holder’s tax basis in its ordinary shares generally will be equal to the U.S. dollar purchase price paid by such U.S. Holder to acquire such ordinary shares. The U.S. dollar cost of ordinary shares purchased with foreign currency generally will be equal to the U.S. dollar value of the purchase price on the date of purchase or, in the case of ordinary shares that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the purchase. Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the U.S. Internal Revenue Service. The holding period of each ordinary share owned by a U.S. Holder will commence on the day following the date of the U.S. Holder’s purchase of such ordinary share and will include the day on which the ordinary share is sold by such U.S. Holder.



In the case of a U.S. Holder who uses the cash basis method of accounting and who receives NIS in connection with a taxable disposition of ordinary shares, the amount realized will be based on the “spot rate” of exchange on the settlement date of such taxable disposition. If such U.S. Holder subsequently converts NIS into U.S. dollars at a conversion rate other than the spot rate in effect on the settlement date, such U.S. Holder may have a foreign currency exchange gain or loss treated as ordinary income or loss for U.S. federal income tax purposes. A U.S. Holder who uses the accrual method of accounting may elect the same treatment required of cash method taxpayers with respect to a taxable disposition of ordinary shares, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the U.S. Internal Revenue Service. If an accrual method U.S. Holder does not elect to be treated as a cash method taxpayer (pursuant to U.S. Treasury Regulations applicable to foreign currency transactions), such U.S. Holder may be deemed to have realized an immediate foreign currency gain or loss for U.S. federal income tax purposes in the event of any difference between the U.S. dollar value of the NIS on the date of the taxable disposition and the settlement date. Any such currency gain or loss generally would be treated as U.S.-source ordinary income or loss and would be subject to tax in addition to any gain or loss recognized by such U.S. Holder on the taxable disposition of ordinary shares.

### **Passive Foreign Investment Company Status**

Generally, a foreign corporation is treated as a passive foreign investment company (“PFIC”) for U.S. federal income tax purposes for any tax year if, in such tax year, either (i) 75% or more of its gross income (including its pro rata share of the gross income of any company in which it is considered to own 25% or more of the shares by value) is passive in nature (the “Income Test”), or (ii) the average percentage of its assets during such tax year (including its pro rata share of the assets of any company in which it is considered to own 25% or more of the shares by value) which produce, or are held for the production of, passive income (determined by averaging the percentage of the fair market value of its total assets which are passive assets as of the end of each quarter of such year) is 50% or more (the “Asset Test”). Passive income for this purpose generally includes dividends, interest, rents, royalties and gains from securities and commodities transactions.

There is no definitive method prescribed in the Code, U.S. Treasury Regulations or relevant administrative or judicial interpretations for determining the value of a publicly-traded foreign corporation’s assets for purposes of the Asset Test. The legislative history of the U.S. Taxpayer Relief Act of 1997 (the “1997 Act”) indicates that for purposes of the Asset Test, “the total value of a publicly-traded foreign corporation’s assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities.” It is unclear whether other valuation methods could be employed to determine the value of a publicly-traded foreign corporation’s assets for purposes of the Asset Test.

Based on the composition of our gross income and the composition and value of our gross assets during each of 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011 and 2012, we do not believe that we were a PFIC during any of such tax years. It is likely, however, that under the asset valuation method described in the legislative history of the 1997 Act, we would have been classified as a PFIC for each of 2001, 2002 and 2003 primarily because (a) a significant portion of our assets consisted of the remaining proceeds of our two public offerings of ordinary shares in 1999, and (b) the public market valuation of our ordinary shares during such years was relatively low. There can be no assurance that we will not be deemed a PFIC in any future tax year.

If we are treated as a PFIC for U.S. federal income tax purposes for any year during a U.S. Holder’s holding period of our ordinary shares and the U.S. Holder does not make a QEF Election or a “mark-to-market” election (both as described below):

- (i) the U.S. Holder would be required to (a) report as ordinary income any “excess distributions” (as defined below) allocated to the current tax year, (b) pay tax on amounts allocated to each prior tax year in which we were a PFIC at the highest rate on ordinary income in effect for such prior year, and (c) pay an interest charge on the resulting tax at the rate applicable to deficiencies of U.S. federal income tax. “Excess distributions” with respect to any U.S. Holder are amounts received by such U.S. Holder with respect to our ordinary shares in any tax year that exceed 125% of the average distributions received by such U.S. Holder from us during the shorter of (i) the three previous years, or (ii) such U.S. Holder’s holding period of our ordinary shares before the then-current tax year. Excess distributions must be allocated ratably to each day that a U.S. Holder has held our ordinary shares.
- (ii) the entire amount of any gain realized by the U.S. Holder upon the sale or other disposition of our ordinary shares also would be treated as an “excess distribution” subject to tax as described above.
- (iii) the tax basis in ordinary shares acquired from a decedent who was a U.S. Holder generally would not receive a step-up to fair market value as of the date of the decedent’s death, but instead would be equal to the decedent’s basis, if lower.

Although we generally will be treated as a PFIC as to any U.S. Holder if we are a PFIC for any year during the U.S. Holder’s holding period, if we cease to be a PFIC, the U.S. Holder may avoid the consequences of PFIC classification for subsequent years by electing to recognize gain based on the unrealized appreciation in such U.S. Holder’s ordinary shares through the close of the tax year in which we cease to be a PFIC.

A U.S. Holder who beneficially owns shares of a PFIC must file U.S. Internal Revenue Service Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund) with the U.S. Internal Revenue Service for each tax year in which such U.S. Holder recognizes gain upon a disposition of our ordinary shares, receives certain distributions from us or makes the QEF Election or mark-to-market election described below.

For any tax year in which we are treated as a PFIC, a U.S. Holder may elect to treat its ordinary shares as an interest in a qualified electing fund (a “QEF Election”), in which case the U.S. Holder would be required to include in income currently its proportionate share of our earnings and profits in years in which we are a PFIC regardless of whether distributions of our earnings and profits are actually made to the U.S. Holder. Any gain subsequently recognized by the U.S. Holder upon the sale or other disposition of its ordinary shares, however, generally would be taxed as capital gain and the denial of the basis step-up at death described above would not apply.

A U.S. Holder may make a QEF Election with respect to a PFIC for any tax year. The election is effective for the tax year for which it is made and all subsequent tax years of the U.S. Holder. Procedures exist for both retroactive elections and the filing of protective statements. A QEF Election is made by completing U.S. Internal Revenue Service Form 8621 and attaching it to a timely-filed (including extensions) U.S. federal income tax return for the first tax year to which the election will apply. A U.S. Holder must satisfy additional filing requirements each year the election remains in effect. Upon a U.S. Holder’s request, we will provide to such U.S. Holder the information required to make a QEF Election and to make subsequent annual filings.

As an alternative to a QEF Election, a U.S. Holder generally may elect to mark its ordinary shares to market annually, recognizing ordinary income or loss (subject to certain limitations) equal to the difference, as of the close of each tax year, between the fair market value of its ordinary shares and the adjusted tax basis of such shares. If a mark-to-market election with respect to ordinary shares is in effect on the date of a U.S. Holder’s death, the normally available step-up in tax basis to fair market value generally will not be available. Rather, the tax basis of ordinary shares in the hands of a U.S. Holder who acquired them from a decedent will be the lesser of the decedent’s tax basis or the fair market value of the ordinary shares. Once made, a mark-to-market election generally continues unless revoked with the consent of the U.S. Internal Revenue Service.

The implementation of many aspects of the Code's PFIC rules requires the issuance of Treasury Regulations which in many instances have yet to be promulgated and which may have retroactive effect when promulgated. We cannot be sure that any of these regulations will be promulgated or, if so, what form they will take or what effect they will have on the foregoing discussion. For example, under legislation enacted in 2010, U.S. Holders are required to file a special information return for each year in which we are treated as a PFIC. The U.S. Internal Revenue Service has revised U.S. Internal Revenue Service Form 8621 by adding a new Part I to implement this requirement, but this new Part I is not required to be completed until the related Treasury Regulations are published. Accordingly, Part I of U.S. Internal Revenue Service Form 8621 has been marked "Reserved For Future Use," and Form 8621 will be revised when Part I becomes effective and is required to be completed.

We urge U.S. holders of our ordinary shares to consult their own tax advisors with respect to the U.S. federal income tax risks related to owning and disposing of our ordinary shares and the consequences of PFIC status.

**Due to the complexity of the PFIC rules and the uncertainty of their application in many circumstances, U.S. Holders should consult their own tax advisors regarding our status as a PFIC and, if we are treated as a PFIC, compliance with the applicable reporting requirements and the eligibility, manner and advisability of making a QEF Election or a mark-to-market election.**

#### **Information Reporting and Backup Withholding**

Payments in respect of our ordinary shares that are made in the U.S. or by certain U.S.-related financial intermediaries may be subject to information reporting requirements and U.S. backup withholding tax at a rate which currently is 28%. The information reporting requirements will not apply, however, to payments to certain U.S. Holders, including corporations and tax-exempt organizations. In addition, the backup withholding tax will not apply to a U.S. Holder that furnishes a correct taxpayer identification number on U.S. Internal Revenue Service Form W-9 (or substitute form). The backup withholding tax is not an additional tax. Amounts withheld under the backup withholding tax rules may be credited against a U.S. Holder's U.S. federal income tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding tax rules by filing the appropriate claim for refund with the U.S. Internal Revenue Service. U.S. Holders should consult their own tax advisors regarding their qualification for an exemption from the backup withholding tax and the procedures for obtaining such an exemption, if applicable.

**The foregoing discussion of certain U.S. federal income tax considerations is a general summary only and should not be considered as income tax advice or relied upon for tax planning purposes. Accordingly, each U.S. Holder should consult with its own tax advisor regarding U.S. federal, state, local and non-U.S. income and other tax consequences of the acquisition, ownership and disposition of our ordinary shares.**

#### *F. DIVIDENDS AND PAYING AGENTS*

Not applicable.

#### *G. STATEMENT BY EXPERTS*

Not applicable.

## **H. DOCUMENTS ON DISPLAY**

We are subject to the informational requirements of the 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 Securities and Exchange Commission, or SEC. You may read and copy any document we file, including any exhibits, with the SEC without charge at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the SEC at such address, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Certain of our SEC filings are also available to the public at the SEC's website at <http://www.sec.gov>.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. However, we file with the Securities and Exchange Commission an annual report on Form 20-F containing consolidated financial statements audited by an independent accounting firm. We also furnish reports on Form 6-K containing unaudited financial information after the end of each of the first three quarters. We intend to post our Annual Report on Form 20-F on our website ([www.audiocodes.com](http://www.audiocodes.com)) promptly following the filing of our Annual Report with the Securities and Exchange Commission.

## **I. SUBSIDIARY INFORMATION**

Not applicable.

## **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to financial market risk associated with changes in foreign currency exchange rates. To mitigate these risks, we use derivative financial instruments. The majority of our revenues and expenses are generated in U.S. dollars. A portion of our expenses, however, is denominated in NIS. In order to protect ourselves against the volatility of future cash flows caused by changes in foreign exchange rates, we use currency forward contracts and currency options. We hedge the part of our forecasted expenses denominated in NIS. If our currency forward contracts and currency options meet the definition of a hedge, and are so designated, changes in the fair value of the contracts will be offset against changes in the fair value of the hedged assets or liabilities through earnings. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change. Our hedging program reduces, but does not eliminate, the impact of foreign currency rate movements and due to the general economic slowdown along with the devaluation of the dollar, our results of operations may be adversely affected. Without taking into account the mitigating effect of our hedging activity, a 10% decrease in the U.S. dollar exchange rates in effect for the year ended December 31, 2012 would cause a decrease in net income of approximately \$4 million.

We are subject to market risk from exposure to changes in interest rates relating to borrowings under our loan agreements. The interest rate on these borrowings is based on LIBOR. Based on our the scheduled amount of these borrowings to be outstanding in 2012, we estimate that each 100 basis point increase in our borrowing rates would result in additional interest expense to us of approximately \$180,000.

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

Not applicable.

## PART II

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

Not applicable.

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

Not applicable.

### ITEM 15. CONTROLS AND PROCEDURES

#### *Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in 13a-15(e) under the Securities Exchange Act) as of December 31, 2012. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were (i) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our management, including our Chief Executive Officer and Chief Financial Officer, by others within those entities, as appropriate to allow timely decisions regarding required disclosure, particularly during the period in which this report was being prepared and (ii) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

#### *Management's Annual Report on Internal Control Over Financial Reporting*

Our management, under the supervision of our Chief Executive Officer and our Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rules 13a-15(f) of the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance to our management and board of directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that:

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

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, 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.

Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2012 based on the framework for Internal Control - Integrated Framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment under that framework and the criteria established therein, our management concluded that the Company's internal control over financial reporting were effective as of December 31, 2012.

*Attestation Report of the Registered Public Accounting Firm*

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

*Changes in Internal Control Over Financial Reporting*

There were no changes in our internal controls over financial reporting identified with the evaluation thereof that occurred during the period covered by this annual report 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**

Our Board of Directors has determined that Joseph Tenne is an “audit committee financial expert” as defined in Item 16A of Form 20-F and is “independent” as defined in the applicable regulations.

**ITEM 16B. CODE OF ETHICS**

We have adopted a Code of Conduct and Business Ethics that applies to our chief executive officer, chief financial officer and other senior financial officers. This Code has been posted on our website, [www.audiocodes.com](http://www.audiocodes.com).

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, has served as our independent public accountants for each of the years in the three-year period ended December 31, 2012. The following table presents the aggregate fees for professional audit services and other services rendered by Kost Forer Gabbay & Kasierer in 2011 and 2012.

	Year Ended December 31, (Amounts in thousands)	
	2011	2012
Audit Fees	\$ 340	\$ 320
Audit Related Fees	84	4
Tax Fees	65	97
Total	<u>\$ 489</u>	<u>\$ 421</u>

Audit Fees consist of fees billed for the annual audit of the company's consolidated financial statements and the statutory financial statements of the company. They also include fees billed for other audit services, which are those services that only the external auditor reasonably can provide, and include services rendered for the integrated audit over internal controls as required under Section 404 of the Sarbanes-Oxley Act applicable in 2011 and 2012, the provision of consents and the review of documents filed with the SEC.

Audit Related Fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the company's financial statements and include operational effectiveness of systems.

Tax Fees include fees billed for tax compliance services, including the preparation of tax returns and claims for refund; tax consultations, such as assistance and representation in connection with tax audits and appeals, transfer pricing, and requests for rulings or technical advice from taxing authorities; tax planning services; and expatriate tax compliance, consultation and planning services.

#### **Audit Committee Pre-approval Policies and Procedures**

The Audit Committee of AudioCodes' Board of Directors is responsible, among other matters, for the oversight of the external auditor subject to the requirements of Israeli law. The Audit Committee has adopted a policy regarding pre-approval of audit and permissible non-audit services provided by our independent auditors (the "Policy").

Under the Policy, proposed services either (i) may be pre-approved by the Audit Committee without consideration of specific case-by-case services as general pre-approval": or (ii) require the specific pre-approval of the Audit Committee as specific pre-approval." The Audit Committee may delegate either type of pre-approval authority to one or more of its members. The appendices to the Policy set out the audit, audit-related, tax and other services that have received the general pre-approval of the Audit Committee, including those described in the footnotes to the table, above; these services are subject to annual review by the Audit Committee. All other audit, audit-related, tax and other services must receive a specific pre-approval from the Audit Committee.

The Audit Committee pre-approves fee levels annually for the audit services. Non-audit services are pre-approved as required. The Chairman of the Audit Committee may approve non-audit services of up to \$25,000 and then request the Audit Committee to ratify his decision.

During 2012, no services provided to AudioCodes by Kost Forer Gabbay & Kasierer were approved by the Audit Committee pursuant to the de minimis exception to the pre-approval requirement provided by paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

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

Not applicable.

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

In 2012, we repurchased a total of approximately 2.76 million ordinary shares at a total cost of \$6.7 million, as set forth below:

<b>Period</b>	<b>(a) Total Number of Ordinary Shares Purchased (1)</b>	<b>(b) Average Price per Ordinary Share</b>	<b>(c) Total Number of Ordinary Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number of Shares Available for Repurchase under the Plans or Programs</b>
	-	-	-	<b>2,795,243</b>
January 1 - January 31	164,752	3.98	164,752	2,630,491
February 1 - February 28	200,591	3.82	200,591	2,429,900
March 1 - March 31	327,098	3.23	327,098	2,102,802
April 1 - April 30	102,802	2.69	102,802	2,000,000
May 1 - May 30	210,385	2.03	210,385	1,789,615
June 1 - June 30	436,947	1.93	436,947	1,352,668
July 1 - July 31	251,185	1.66	251,185	1,101,483
August 1 - August 31	362,093	1.45	362,093	1,399,809
September 1 - September 30	660,419	2.22	660,419	739,390
October 3	43,322	2.71	43,322	78,971
<b>Total</b>	<b>2,759,594</b>	<b>3.39</b>	<b>2,759,594</b>	

(1) On October 3, 2011, we announced that our Board had authorized a program to repurchase our shares. The program provided for purchases of up to 4,000,000 of our ordinary shares. Purchases under this plan were completed as of October 2012.

#### **ITEM 16F. CHANGE IN REGISTRANT'S CERTIFIED ACCOUNTANT**

Not applicable.

#### **ITEM 16G. CORPORATE GOVERNANCE**

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules.

We do not comply with the NASDAQ requirement that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans. Instead, we follow Israeli law and practice which permits the establishment or amendment of certain equity based compensation plans approved by our board of directors without the need for a shareholder vote, unless such arrangements are for the compensation of directors and the chief executive officer, in which case they also require compensation committee and shareholder approval.

We may elect in the future to follow Israeli practice with regard to, among other things, director nomination, composition of the board of directors and quorum at shareholders' meetings. In addition, we may follow Israeli law, instead of the NASDAQ Marketplace Rules, which require that we obtain shareholder approval for an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company.



A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements, must submit to NASDAQ in advance a written statement from an independent counsel in its home country certifying that its practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission or on its website each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

For a discussion of the requirements of Israeli law with respect to these matters, see Item 6.C. "Directors, Senior Management and Employees - Board Practices," and Item 10.B. "Additional Information - Memorandum and Articles of Association."

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

Reference is made to pages F-1 to F-51 hereto.

**ITEM 19. EXHIBITS**

The following exhibits are filed as part of this Annual Report:

<b>Exhibit No.</b>	<b>Document</b>
1.1	Memorandum of Association of Registrant.(1)‡
1.2	Articles of Association of Registrant, as amended. (2)
2.1	Indenture, dated November 9, 2004, between AudioCodes Ltd. and U.S. Bank National Association, as Trustee, with respect to the 2.00% Senior Convertible Notes due 2024.(3)
4.1	AudioCodes Ltd. 1997 Key Employee Option Plan (C).(1)
4.2	AudioCodes Ltd. 1997 Key Employee Option Plan, Qualified Stock Option Plan-U.S. Employees (D).(1)
4.3	License Agreement between AudioCodes Ltd. and DSP Group, Inc., dated as of May 6, 1999.(1)
4.4	AudioCodes Ltd. 1997 Key Employee Option Plan (D).(1)
4.5	AudioCodes Ltd. 1997 Key Employee Option Plan (E).(1)
4.6	AudioCodes Ltd. 1999 Key Employee Option Plan (F), as amended.(4)

Exhibit No.	Document
4.7	AudioCodes Ltd. 1997 Key Employee Option Plan, Qualified Stock Option Plan-U.S. Employees (E).(1)
4.8	AudioCodes Ltd. 1999 Key Employee Option Plan, Qualified Stock Option Plan-U.S. Employees (F).(4)
4.9	AudioCodes Ltd. 2001 Employee Stock Purchase Plan-Global Non U.S., as amended.(5)
4.10	AudioCodes Ltd. 2001 U.S. Employee Stock Purchase Plan, as amended.(5)
4.11	AudioCodes Ltd. 2007 U.S. Employee Stock Purchase Plan.(6)
4.12	Sublease Agreement between AudioCodes USA, Inc. and Continental Resources, Inc., dated December 30, 2003.(7)
4.13	Employment Agreement between AudioCodes Ltd. and Shabtai Adlersberg.(8)
4.14	Building and Tenancy Lease Agreement, dated May 11, 2007, by and between Airport City Ltd. and AudioCodes Ltd.(9) †
4.15	AudioCodes Ltd. 2008 Equity Incentive Plan.(11)
4.16	Amendment to AudioCodes Ltd. 2008 Equity Incentive Plan.(12)
4.17	Loan Requests, dated May 13, 2008, between First International Bank of Israel, as lender, and AudioCodes Ltd., as borrower.*‡
4.18	Loan Requests, dated September 27, 2011, between First International Bank of Israel, as lender, and AudioCodes Ltd., as borrower.*‡
4.19	Restated Undertaking Letter to First International Bank of Israel, dated May 6, 2008.*‡
4.20	Amendments to Undertaking Letter to First International Bank of Israel, dated September 15, 2009, February 16, 2009, September 26, 2011, December 29, 2011 and July 23, 2012.*‡
4.21	Letter Agreement, dated July 14, 2008, between Bank Mizrahi Tefahot Ltd., as lender, and AudioCodes Ltd., as borrower.*‡
4.22	Secured Bond, dated July 14, 2008, delivered by AudioCodes Ltd., as borrower, in favor of Bank Mizrahi Tefahot Ltd., as lender.*‡
4.23	Undertaking Letter to Bank Mizrahi Tefahot Ltd, dated December 12, 2011.*‡
4.24	Deed of Pledge of Rights, dated December 12, 2011, delivered by AudioCodes Ltd., as borrower, in favor of Bank Mizrahi Tefahot Ltd., as lender.*‡
4.25	Amendment to Undertaking Letter to Bank Mizrahi Tefahot Ltd., dated July 23, 2012.*‡
4.26	Loan Requests, dated September 27, 2011, between Bank Leumi Israel Ltd., as lender, and AudioCodes Ltd., as borrower.*‡
4.27	Undertaking Letter to Bank Leumi Israel Ltd., dated December 12, 2011.*‡
4.28	Amendment to Undertaking Letter to Bank Leumi Israel Ltd., dated July 24, 2012.*‡
4.29	Form of Insurance, Indemnification and Exculpation Agreement between the Registrant and each of its directors and executive officers. (13)
8.1	Subsidiaries of the Registrant. (2)
12.1	Certification of Shabtai Adlersberg, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *

Exhibit No.	Document
12.2	Certification of Guy Avidan, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
13.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
13.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
15.1	Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global. *
101.1	Interactive Data Files (XBRL-Related Documents). * #

† English summary of Hebrew original.

‡ English translation of Hebrew original.

\* Filed herewith.

# Pursuant to Rule 406T of Regulation S-T, the information in Exhibit 101 is furnished and deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

- (1) Incorporated by reference to Registrant's Registration Statement on Form F-1 (File No. 333-10352).
- (2) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2011.
- (3) Incorporated by reference to Registrant's Registration Statement on Form F-3 (File No. 333-123859).
- (4) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2002.
- (5) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 333-144823).
- (6) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 333-144825).
- (7) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2003.
- (8) Incorporated by reference to Exhibit 1 to Registrant's Form 6-K filed on November 12, 2009.
- (9) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2006.
- (10) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2007.
- (11) Incorporated by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2008.
- (12) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 333-170676).
- (13) Incorporated by reference to Exhibit 1 to Registrant's Form 6-K filed on November 10, 2011.

## SIGNATURES

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 Form 20-F on its behalf.

AUDIOCODES LTD.

By: /s/ SHABTAI ADLERSBERG  
Shabtai Adlersberg  
President and Chief Executive Officer

Date: April 10, 2013

**AUDIOCODES LTD.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2012**  
**IN U.S. DOLLARS**  
**INDEX**

	<u>Page</u>
<b>Report of Independent Registered Public Accounting Firm</b>	<b>2 - 4</b>
<b>Consolidated Balance Sheets</b>	<b>5 - 6</b>
<b>Consolidated Statements of Operations</b>	<b>7</b>
<b>Consolidated Statements of Comprehensive Income (Loss)</b>	<b>8</b>
<b>Statements of Changes in Equity</b>	<b>9</b>
<b>Consolidated Statements of Cash Flows</b>	<b>10 - 11</b>
<b>Notes to Consolidated Financial Statements</b>	<b>12 - 51</b>

-----

---



**Kost Forer Gabbay & Kasierer**

3 Aminadav St.  
Tel-Aviv 6706703, Israel

Tel: 972 (3)6232525

Fax: 972 (3)5622555

www.ey.com

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**AUDIOCODES LTD.**

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

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

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 10, 2013 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
April 10, 2013

/s/ Kost Forer Gabbay & Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global



**Kost Forer Gabbay & Kasierer**

3 Aminadav St.  
Tel-Aviv 6706703, Israel

Tel: 972 (3)6232525

Fax: 972 (3)5622555

www.ey.com

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**AUDIOCODES LTD.**

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

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

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



**Kost Forer Gabbay & Kasierer**

3 Aminadav St.  
Tel-Aviv 6706703, Israel

Tel: 972 (3)6232525

Fax: 972 (3)5622555

www.ey.com

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of AudioCodes and subsidiaries as of December 31, 2011 and 2012 and the related consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for each of the three years in the period ended December 31, 2012 and our report dated April 10, 2013 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
April 10, 2013

/s/ Kost Forer Gabbay & Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global



## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2011	2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 28,257	\$ 15,219
Short-term and restricted bank deposits	14,008	10,330
Short-term marketable securities and accrued interest	345	7,966
Trade receivables (net of allowance for doubtful accounts of \$ 1,461 and \$ 2,146 at December 31, 2011 and 2012, respectively)	30,923	24,413
Other receivables and prepaid expenses	4,477	5,653
Deferred tax assets, net	2,600	1,621
Inventories	20,415	16,797
<b>Total</b> current assets	<b>101,025</b>	<b>81,999</b>
<b>LONG-TERM ASSETS:</b>		
Long-term and restricted bank deposits	9,120	9,251
Long-term marketable securities	23,823	15,762
Investment in an affiliated company	1,251	1,084
Deferred tax assets, net	2,600	3,565
Severance pay funds	15,410	15,772
<b>Total</b> long-term assets	<b>52,204</b>	<b>45,434</b>
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>3,368</b>	<b>3,619</b>
<b>INTANGIBLE ASSETS, NET</b>	<b>3,985</b>	<b>2,857</b>
<b>GOODWILL</b>	<b>32,095</b>	<b>32,095</b>
<b>Total</b> assets	<b>\$ 192,677</b>	<b>\$ 166,004</b>

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

## CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2011	2012
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term loan and current maturities of long-term bank loans	\$ 10,243	\$ 8,436
Trade payables	12,362	6,817
Other payables and accrued expenses	18,102	15,062
Deferred revenues	5,235	5,086
<b>Total current liabilities</b>	<b>45,942</b>	<b>35,401</b>
<b>LONG-TERM LIABILITIES:</b>		
Accrued severance pay	16,106	16,284
Senior convertible notes	353	353
Long-term banks loans	22,912	14,477
Deferred revenues and other liabilities	1,345	1,192
<b>Total long-term liabilities</b>	<b>40,716</b>	<b>32,306</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>EQUITY:</b>		
Share capital -		
Ordinary shares of NIS 0.01 par value -		
Authorized: 100,000,000 shares at December 31, 2011 and 2012; Issued: 49,159,897 shares at December 31, 2011 and 49,332,510 shares at December 31, 2012; Outstanding: 40,562,784 shares at December 31, 2011 and 37,975,803 shares at December 31, 2012	119	112
Additional paid-in capital	196,021	197,653
Treasury stock at cost- 8,597,113 shares as of December 31, 2011 and 11,356,707 shares at December 31, 2012	(29,055)	(35,768)
Accumulated other comprehensive income (loss)	(240)	1,303
Accumulated deficit	(60,826)	(65,003)
<b>Total equity</b>	<b>106,019</b>	<b>98,297</b>
<b>Total liabilities and equity</b>	<b>\$ 192,677</b>	<b>\$ 166,004</b>

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

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2010	2011	2012
<b>Revenues:</b>			
Products	\$ 132,662	\$ 135,802	\$ 103,651
Services	17,378	20,025	23,839
<b>Total revenues</b>	<b>150,040</b>	<b>155,827</b>	<b>127,490</b>
<b>Cost of revenues:</b>			
Products	62,155	59,917	48,371
Services	3,983	4,228	5,923
<b>Total cost of revenues</b>	<b>66,138</b>	<b>64,145</b>	<b>54,294</b>
<b>Gross profit</b>	<b>83,902</b>	<b>91,682</b>	<b>73,196</b>
<b>Operating expenses:</b>			
Research and development, net	30,189	32,150	28,677
Selling and marketing	35,024	43,248	40,040
General and administrative	8,252	9,028	8,214
<b>Total operating expenses</b>	<b>73,465</b>	<b>84,426</b>	<b>76,931</b>
Operating income (loss)	10,437	7,256	(3,735)
Financial income (expenses), net	(94)	423	453
Income (loss) before taxes on income	10,343	7,679	(3,282)
Income tax benefit (expense), net	1,885	(238)	(541)
Equity in losses of an affiliated company	(213)	(277)	(354)
<b>Net income (loss)</b>	<b>12,015</b>	<b>7,164</b>	<b>(4,177)</b>
Net loss attributable to non-controlling interest	111	-	-
<b>Net income (loss) attributable to AudioCodes' shareholders</b>	<b>\$ 12,126</b>	<b>\$ 7,164</b>	<b>\$ (4,177)</b>
<b>Basic and diluted net earnings (loss) per share attributable to AudioCodes shareholders</b>	<b>\$ 0.30</b>	<b>\$ 0.17</b>	<b>\$ (0.11)</b>

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

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

U.S. dollars in thousands

	Year ended December 31,		
	2010	2011	2012
Net income (loss)	\$ 12,126	\$ 7,164	\$ (4,177)
Other comprehensive income (loss), related to unrealized gains (loss) on cash flow hedges	724	(1,062)	1,543
Total comprehensive income (loss)	<u>12,850</u>	<u>6,102</u>	<u>(2,634)</u>

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

## STATEMENTS OF CHANGES IN EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income	Retained earnings (accumulated deficit)	Non- controlling interest	Total equity
Balance as of January 1, 2010	\$ 125	\$ 189,079	\$ (25,057)	\$ 98	\$ (80,116)	\$ (244)	\$ 83,885
Issuance of shares upon exercise of options	3	2,553	-	-	-	-	2,556
Stock compensation related to options granted to employees	-	1,370	-	-	-	-	1,370
Acquisition of NSC non-controlling interest	-	(1,725)	-	-	-	355	(1,370)
Comprehensive income, net:							
Unrealized gain on foreign currency cash flow hedges	-	-	-	724	-	-	724
Net income (loss)	-	-	-	-	12,126	(111)	12,015
Balance as of December 31, 2010	128	191,277	(25,057)	822	(67,990)	-	99,180
Purchase of treasury stock	(11)	-	(3,998)	-	-	-	(4,009)
Issuance of shares upon exercise of options and employee stock purchase plan	2	1,703	-	-	-	-	1,705
Stock compensation related to options granted to employees	-	3,041	-	-	-	-	3,041
Comprehensive income, net:							
Unrealized loss on foreign currency cash flow hedges	-	-	-	(1,062)	-	-	(1,062)
Net income	-	-	-	-	7,164	-	7,164
Balance as of December 31, 2011	119	196,021	(29,055)	(240)	(60,826)	-	106,019
Purchase of treasury stock	(7)	-	(6,713)	-	-	-	(6,720)
Issuance of shares upon exercise of options	-	103	-	-	-	-	103
Stock compensation related to options granted to employees	-	1,529	-	-	-	-	1,529
Comprehensive loss, net:							
Unrealized gain on foreign currency cash flow hedges	-	-	-	1,543	-	-	1,543
Net loss	-	-	-	-	(4,177)	-	(4,177)
Balance as of December 31, 2012	<u>\$ 112</u>	<u>\$ 197,653</u>	<u>\$ (35,768)</u>	<u>\$ 1,303</u>	<u>\$ (65,003)</u>	<u>\$ -</u>	<u>\$ 98,297</u>

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2010	2011	2012
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ 12,015	\$ 7,164	\$ (4,177)
Adjustments required to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	4,359	3,239	2,883
Amortization of marketable securities premiums and accretion of discounts, net	-	416	436
Equity in losses of an affiliated company and interest on loans to an affiliated company	213	277	350
Stock-based compensation	1,370	2,323	1,529
Decrease (increase) in accrued interest on loans, marketable securities and bank deposits	(20)	(182)	4
Decrease (increase) in deferred tax assets, net	(2,321)	(652)	14
Decrease (increase) in trade receivables, net	(7,799)	(4,602)	6,510
Decrease (increase) in other receivables and prepaid expenses	(218)	(403)	127
Decrease (increase) in inventories	(3,963)	(4,136)	3,618
Increase (decrease) in trade payables	4,910	(1,157)	(5,545)
Increase (decrease) in other payables and accrued expenses and other liabilities	6,324	(5,464)	(3,054)
Increase in deferred revenues	1,851	1,978	485
Decrease in accrued severance pay, net	(319)	(86)	(184)
Net cash provided by (used in) operating activities	16,402	(1,285)	2,996
<b>Cash flows from investing activities:</b>			
Net loans provided to affiliated company	-	(211)	(183)
Purchase of property and equipment	(1,569)	(1,579)	(2,006)
Purchase of marketable securities	-	(24,402)	-
Short-term and restricted bank deposits, net	77	(183)	3,678
Investment in long-term and restricted bank deposits	-	(9,120)	(131)
Net cash provided by (used in) investing activities	(1,492)	(35,495)	1,358

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2010	2011	2012
<b>Cash flows from financing activities:</b>			
Purchase of treasury stock	-	(3,812)	(6,917)
Redemption of senior convertible notes	(50)	-	-
Proceeds from long-term bank loans	-	24,005	-
Repayment of long-term bank loans	(6,000)	(6,600)	(10,242)
Payment for acquisition of NSC non-controlling interest	(74)	(278)	(336)
Proceeds from issuance of shares upon exercise of options, warrants and employee stock purchase plan	2,556	1,411	103
Net cash provided by (used in) financing activities	<u>(3,568)</u>	<u>14,726</u>	<u>(17,392)</u>
Increase (decrease) in cash and cash equivalents	11,342	(22,054)	(13,038)
Cash and cash equivalents at the beginning of the year	38,969	50,311	28,257
Cash and cash equivalents at the end of the year	<u>\$ 50,311</u>	<u>\$ 28,257</u>	<u>\$ 15,219</u>
<b>Supplemental disclosure of cash flow activities:</b>			
Cash paid during the year for income taxes	<u>\$ 261</u>	<u>\$ 848</u>	<u>\$ 313</u>
Cash paid during the year for interest	<u>\$ 317</u>	<u>\$ 356</u>	<u>\$ 789</u>
<b>Supplemental disclosures of non cash operational, financing and investing activities</b>			
Net change in gain (loss) on foreign currency cash flow hedges	<u>\$ 724</u>	<u>\$ (1,062)</u>	<u>\$ 1,543</u>
Total commitment for future payments for NSC acquisition which reduced the Company's equity	<u>\$ 1,296</u>	<u>\$ -</u>	<u>\$ -</u>
Total commitment in respect of treasury stock purchasing	<u>\$ -</u>	<u>\$ 197</u>	<u>\$ -</u>
Conversion of employees stock purchase plan liability to equity upon issuance of shares	<u>\$ -</u>	<u>\$ 294</u>	<u>\$ -</u>

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1:- GENERAL**

## a. Business overview:

AudioCodes Ltd. ("the Company") and its subsidiaries (together the "Group") design, develop and market products and services for voice, data and video over IP networks to service providers and channels (such as distributors), OEMs, network equipment providers and systems integrators.

The Company operates through its wholly-owned subsidiaries in the United States, Europe, Asia, Latin America and Israel.

## b. Acquisition of Natural Speech Communication Ltd. ("NSC"):

Through December 31, 2009, the Company had invested an aggregate of \$ 8,418 in NSC, a privately-held company engaged in speech recognition. As of December 31, 2009, the Company owned 59.7% of the outstanding share capital of NSC, which has been consolidated into the financial results of the Company since December 2008.

In January 2010, the Company entered into an agreement to acquire all of the outstanding equity of NSC that it did not own as of December 31, 2009. The closing of the transaction occurred in May 2010. Pursuant to the agreement, the Company purchased the remaining 40.3% of the shares from NSC's non-controlling shareholders for a maximum total consideration of \$ 1,733, which includes payments to employees, who were also former NSC's shareholders, that exceeded the fair value of NSC's shares. As a result, the payments in excess of fair value were treated as employee related expenses. The payment of the total consideration can be made, at the Company's option, in any combination of cash and the Company's shares. In accordance with the agreement, \$ 224, \$ 278 and \$ 336 were paid in cash in the years ended December 31, 2010, 2011 and 2012 respectively. An additional amount of \$ 395 was paid in March 2013. Additional earn-out consideration of up to \$ 500 is payable in 2013, since certain aggregate revenue milestones were met for the years ended December 31, 2010, 2011 and 2012. The obligation to pay the consideration to the former NSC shareholders was recorded in the balance sheet as a liability.

The liability recorded was comprised of two components: (1) The contingent payments for which the Company recorded a contingent consideration liability of \$ 329 based on its estimated fair value as of the closing of the transaction. This amount was estimated by utilizing an income approach, taking into account the potential cash payments based on the Company's expectation as to NSC's future revenues in each of the years ended December 31, 2010, 2011 and 2012, and was discounted to arrive at a present value amount.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

---

**NOTE 1:- GENERAL (Cont.)**

The discount rate was based on the market interest rate and NSC's estimated operational capitalization rate. The contingent consideration liability was marked to market at fair value at each reporting date based on the Company's policy with subsequent changes in the value of the liability recorded in finance expenses in the statement of operations, while changes due to changes in estimates were recorded within operating income or expenses and (2) A liability with respect to the commitment for future payments was recorded at present value which amounted to \$ 967. Such obligation is not re-measured at subsequent periods and would only be adjusted for changes in time value. As this was an equity transaction between

AudioCodes and NSC's non-controlling shareholders, the Company reduced its equity by \$ 1,370 for the excess costs over book value related to the non-controlling interest in NSC, as required in accordance with Accounting Standards Codification ("ASC") 810, "Consolidation".

As of December 31, 2011 and 2012, the contingent consideration liability estimated fair value amounted to \$ 412 and \$ 115, respectively, and the liability with respect to the commitment for future payments amounted to \$ 707 and \$ 391, respectively. Of the total liability, as of December 31, 2011, an aggregate amount equal to \$ 787 was classified as a long-term liability, while as of December 31, 2012, the total liability was classified as a short-term liability.

- c. The Group is dependent upon sole source suppliers for certain key components used in its products, including certain digital signal processing chips. Although there are a limited number of manufacturers of these particular components, management believes that other suppliers could provide similar components at comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which could adversely affect the operating results of the Group and its financial position.
- d. The Group's major customer in the years ended December 31, 2010, 2011 and 2012, accounted for 10%, 14.4% and 13.7% of the Group's revenues in those years, respectively. No other customer accounted for more than 10% of the Group's revenues in those periods.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

---

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

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

a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they are made. As applicable to these consolidated financial statements, the most significant estimates and assumptions relate to revenue recognition and allowance for sales returns, allowance for doubtful accounts, inventories, intangible assets, goodwill, income taxes and valuation allowance, stock-based compensation and contingent liabilities. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars ("dollars"):

A majority of the Group's revenues is generated in dollars. In addition, most of the Group's costs are denominated and determined in dollars and in new Israeli shekels. The Company's management believes that the dollar is the currency in the primary economic environment in which the Group operates. Thus, the functional and reporting currency of the Group is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with ASC 830, "Foreign Currency Matters". All transaction gains and losses of the remeasured monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

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

The Group accounts for non-controlling interest in a subsidiary in accordance with ASC 810, "Consolidation". According to ASC 810, a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as a separate component of equity in the consolidated financial statements. As such, changes in the parent's ownership interest with no change of control are treated as equity transactions, rather than step acquisitions or gain or loss resulting from dilution in the holdings of a subsidiary. ASC 810 clarifies that losses of partially-owned consolidated subsidiaries will continue to be allocated to the non-controlling interest even when the investment has already been reduced to zero.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

According to the Company's policy, contingent consideration related to the acquisition of non-controlling interests is presented at fair value in subsequent periods and changes in fair value of the liability will be recorded as financial income/expense.

d. Cash equivalents:

Cash equivalents represent short-term highly liquid investments that are readily convertible into cash with original maturities of three months or less, at the date acquired.

e. Short-term and restricted bank deposits:

Short-term and restricted bank deposits are deposits with maturities of more than three months but less than one year. The deposits are mainly in dollars and bear interest at an average rate of 1.50% and 0.81% for 2011 and 2012, respectively. Short-term and restricted deposits are presented at their cost. Any accrued interest on these deposits is included in other receivables and prepaid expenses.

In connection with the long-term bank loans and their related covenants, the Company is required to maintain compensating balances with the banks and to maintain deposits in the same banks that provided the loans (see Note 11). In addition, the Company maintains restricted deposits in connection with foreign exchange transactions and in connection with the office lease agreement (see Note 12a). Out of the short term and restricted bank deposits, a total of \$ 12,934 and \$ 10,330 are restricted short-term deposits as of December 31, 2011 and 2012, respectively.

f. Marketable securities:

The Company accounts for investments in debt securities in accordance with ASC 320, "Investments-Debt and Equity Securities".

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. For the year ended December 31, 2012, all securities are classified as held-to-maturity since the Company has the intent and ability to hold the securities to maturity and, accordingly, debt securities are stated at amortized cost.

The amortized cost of held-to-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity and any other than temporary impairment losses. Such amortization and interest are included in the consolidated statement of operations as financial income or expenses, as appropriate.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

For the years ended December 31, 2011 and 2012, no other than temporary impairment losses have been identified. During the year ended December 31, 2010, the Group did not hold any marketable securities.

## g. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows:

Raw materials - using the "weighted average cost" method.

Finished products - using the "weighted average cost" method with the addition of direct manufacturing costs.

The Group periodically evaluates the quantities on hand relative to current and historical selling prices, historical and projected sales volume and technological obsolescence. Based on these evaluations, inventory write-offs are taken based on slow moving items, technological obsolescence, excess inventories, discontinuation of products lines and for market prices lower than cost.

## h. Long-term and restricted bank deposits:

Bank deposits with maturities of more than one year are included in long-term investments and presented at their cost. Accrued interest is included in other receivables and prepaid expenses. The deposits are in dollars and bear interest at an average rate of 2.52% and 2.54% for 2011 and 2012, respectively. In connection with the long term bank loans, the Company is required to maintain compensating balances with the banks (see Note 11). Out of the total long-term bank deposits, a total of \$ 8,820 and \$ 9,251 are restricted long-term deposits as of December 31, 2011 and 2012, respectively. The Company is required to maintain deposits in the same banks that provided the loans.

## i. Investment in an affiliated company:

The Company accounts for investment in affiliated company in which it has the ability to exercise significant influence over the operating and financial policies using the equity method of accounting in accordance with the requirements of ASC 323, "Investments - Equity Method and Joint Ventures".

Investment in affiliated company represents investment in ordinary shares, preferred shares, convertible loans and non-convertible loans. According to ASC 323, additional losses of such company in excess of the carrying amount of the equity investment are recognized based on the seniority level (priority in liquidation) of the particular type of investment held by the Company.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

The Company's investment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable in accordance with ASC 323. During the years ended December 31, 2010, 2011 and 2012, no impairment losses had been identified.

## j. 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 and peripheral equipment	33
Office furniture and equipment	6 - 20 (mainly 15%)
Leasehold improvements	Over the shorter of the term of the lease or the life of the asset

## k. Impairment of long-lived assets:

The Group's long-lived assets are reviewed for impairment in accordance with ASC 360-10-35, "Property, Plant and Equipment - Subsequent Measurement", whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets (asset group) to be held and used is measured by a comparison of the carrying amount of an asset (asset group) to the future undiscounted cash flows expected to be generated by the asset if such assets are considered to be impaired. The impairment to be recognized is measured by the amount by which the carrying amount of the assets (asset groups) exceeds the fair value of the assets (asset groups). The loss is allocated to the long-lived assets of the Group on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the Group will not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable. During the years ended December 31, 2010, 2011 and 2012, no impairment losses had been identified for property and equipment since the fair value of those assets (asset groups) was higher than its carrying amounts.

Intangible assets are comprised of acquired technology, customer relations, trade names and existing contracts for maintenance.

Intangible assets that are not considered to have an indefinite useful life are amortized using the straight-line basis over their estimated useful lives, which range from one to ten years. Recoverability of these assets is measured by a comparison of the carrying amount of the asset to the undiscounted future cash flows expected to be generated by the assets. If the assets are considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired assets.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

During the years ended December 31, 2010, 2011 and 2012, no impairment losses were identified.

## 1. Goodwill:

Goodwill and certain other purchased intangible assets have been recorded as a result of acquisitions. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill is not amortized, but rather is subject to an impairment test.

The Group performs an annual impairment test during the fourth quarter of each fiscal year, or more frequently if impairment indicators are present. The Group operates in one operating segment, and this segment comprises its only reporting unit.

ASC 350 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. In such case, the second phase is then performed, and the Group measures impairment by comparing the carrying amount of the reporting unit's goodwill to the implied fair value of that goodwill. An impairment loss is recognized in an amount equal to the excess. In September 2011, the Financial Accounting Standards Board ("FASB") issued guidance which provides an entity the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The Group believes that the adoption of this guidance did not have a material impact on its consolidated financial statements.

In July 2012, the FASB issued Accounting Standard Update 2012-02, "Intangibles - Goodwill and Other (Topic 350): Testing Indefinite Intangibles Assets for Impairment", which amended the guidance in ASC 350-30 on testing indefinite-lived intangible assets, other than goodwill, for impairment allowing an entity to perform a qualitative impairment assessment. If the entity determines that it is not more likely than not that the fair value of the reporting unit is less than the carrying amount, further testing of indefinite-lived intangible assets for impairment is not required and the entity would not need to calculate the fair value of the asset and perform a quantitative impairment test. In addition, the standard did not amend the requirement to test these assets for impairment between annual tests if there is a change in events or circumstances; however, it revised the examples of events and circumstances that an entity should consider in interim periods, which are identical to those assessed in the annual qualitative assessment described above. ASU 2012-02 was effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption being permitted. The Company adopted the guidance however was not required to use it.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

For each of the three years in the period ended December 31, 2012, the Group performed an annual impairment analysis, using market capitalization, and no impairment losses have been identified.

m. Revenue recognition:

The Group generates its revenues primarily from the sale of products through a direct sales force and sales representatives. The Group's products are delivered to its customers, which include original equipment manufacturers, network equipment providers, systems integrators and distributors in the telecommunications and networking industries, all of whom are considered end-users.

Revenues from products and services are recognized in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition", when the following criteria are met: persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable. The Group has no remaining obligation to customers after the date on which products are delivered other than pursuant to warranty obligations and right of return.

In a multiple element arrangement, ASU No. 2009-13, Topic 605 – "Multiple-Deliverable Revenue Arrangements" requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price.

The selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available. The Group then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. VSOE of selling price is based on the price charged when the element is sold separately. In determining VSOE, the Group requires that a substantial majority of the selling prices fall within a narrow range based on stand-alone rates. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as the Group's products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as the Group is unable to reliably determine what competitors products' selling prices are on a stand-alone basis, the Group is not typically able to determine TPE. The ESP is established considering multiple factors including, but not limited to, pricing practices in different geographical areas and through different sales channels, gross margin objectives, internal costs, competitors' pricing strategies, and industry technology lifecycles. The selling price of the products and professional services was based on ESP. Maintenance selling price was based on VSOE.

The Group limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or subject to customer-specific return or refund privileges. The Group evaluates each deliverable in an arrangement to determine whether they represent separate units of accounting.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

Prior to 2011, the Group allocated revenue to each element using the residual method when the VSOE of fair value of the undelivered items for arrangements with multiple elements, such as sales of products that include services and software, exists. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. If VSOE of one or more undelivered items did not exist, revenue from the entire arrangement was deferred and recognized at the earlier of: (i) delivery of those elements or (ii) when fair value could be established unless maintenance was the only undelivered element, in which case, the entire arrangement fee was recognized ratably over the contractual support period.

ASU 2009-13 did not have a significant impact on the Group's net revenues for the years ended December 31, 2011 and 2012, compared to the net revenues that would have been recorded under the previous accounting rules.

The Group grants to certain customers a right of return or the ability to exchange a specific percentage of the total price paid for products they have purchased over a limited period for other products. The Group maintains a provision for product returns and exchanges and other incentives based on its experience with historical sales returns, analysis of credit memo data and other known factors, in accordance with SAB 104. The provision was deducted from revenues and amounted to \$ 823 and \$ 1,232 as of December 31, 2011 and 2012, respectively.

Revenues from the sale of products which were not yet determined to be final sales due to acceptance provisions are deferred and included in deferred revenues. In cases where collectability is not probable, revenues are deferred and recognized upon collection.

n. Warranty costs:

The Group generally provides a warranty period of 12 months at no extra charge. The Group 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 Group's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Group periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. As of December 31, 2011 and 2012, the provision for warranty amounted to \$ 707 and \$ 497, respectively.

o. Research and development costs:

Research and development costs, net of government grants received, are charged to the statement of operations as incurred. The total government grants presented as a reduction from research and development costs during the years ended December 31, 2010, 2011 and 2012 were \$ 3,912, \$ 2,776 and \$ 2,729, respectively.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

## p. Income taxes:

The Group accounts for income taxes in accordance with ASC 740, "Income Taxes". ASC 740 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 carry forward 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 Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

In addition, ASC 740 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The first step is to evaluate the tax position taken or expected to be taken in a tax return. This is done 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 Group accrues interest and penalties, if any, related to unrecognized tax benefits in tax expenses.

## q. Comprehensive income (loss):

The Group accounts for comprehensive income (loss) in accordance with ASC 220, "Comprehensive Income". ASC 220 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income (loss) generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. The Group determined that its items of comprehensive income (loss) relate to gains and losses on hedging derivatives instruments.

The Group presents total comprehensive income (loss) in accordance with ASU 2011-05, Topic 220. "Presentation of Comprehensive Income" and ASU 2011-12, Topic 220 - Comprehensive Income. ASU 2011-05 requires an entity to present, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The Group chose to present the components of net income and other comprehensive income in two separate but consecutive statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

## r. Concentrations of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, bank deposits, trade receivables and foreign currency derivative contracts.

The majority of the Group's cash and cash equivalents and bank deposits are invested in dollar instruments with major banks in Israel and the United States. Such investments in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Group's investments are corporations with high credit standing. Accordingly, management believes that low credit risk exists with respect to these financial investments.

Marketable securities include investments in debentures of U.S corporations. Marketable securities consist of highly liquid debt instruments of corporations with high credit standing. Management believes that the portfolio is well diversified and, accordingly, minimal credit risk exists with respect to these marketable debt securities.

The trade receivables of the Group are derived from sales to customers located primarily in the Americas, the Far East, Israel and Europe. However, under certain circumstances, the Group may require letters of credit, other collateral, additional guarantees or advance payments. Regarding certain credit balances, the Group is covered by foreign trade risk insurance. The Group performs ongoing credit evaluations of its customers and establishes an allowance for doubtful accounts based upon a specific review.

## s. Senior convertible notes:

The Company accounts for senior convertible notes in accordance with ASC 470-20, "Debt with Conversion and Other Options". ASC 470-20 specifies that issuers of such instruments should separately account for the liability and equity components on the issuance day in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. See also Note 10.

The Company presents the outstanding principal amount of its senior convertible notes as a long-term liability, in accordance with ASC 210-10-45 (based on its expected redemption, taking into consideration redemption options of the holders). The debt is classified as a long-term liability until the date of conversion on which it would be reclassified to equity, or within one year of the first contractual redemption date, on which it would be reclassified as a short-term liability. Accrued interest on the senior convertible notes is included in "other payables and accrued expenses".

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

According to ASC 470-20, if an instrument within its scope is repurchased, an issuer shall allocate the consideration transferred and related transaction costs incurred, to the extinguishment of the liability component and the reacquisition of the equity component. See also Note 10.

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

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year, plus potential dilutive ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share".

Senior convertible notes and certain outstanding stock options, restricted share units ("RSUs") and warrants have been excluded from the calculation of the diluted net income per ordinary share since such securities are anti-dilutive for all years presented. The total weighted average number of shares related to the senior convertible notes and outstanding options, RSUs and warrants that have been excluded from the calculations of diluted net income per share was 3,848,284, 2,727,374 and 4,072,517 for the years ended December 31, 2010, 2011 and 2012, respectively.

u. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation-Stock Compensation". ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statement of operations.

The Company recognizes compensation expenses for the value of its awards based on the accelerated method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company applies ASC 718 and ASC 505-50, "Equity-Based Payments to Non-Employees" with respect to options and warrants issued to non-employees. Accordingly, the Company uses option valuation models to measure the fair value of the options and warrants at the measurement date as defined in ASC 505-50.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

The Company accounted for changes in award terms as a modification in accordance with ASC 718. 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 measured at the same date. Under ASC 718, 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 award measured immediately before its terms are modified based on current circumstances.

The weighted-average estimated fair value of employee stock options granted during the years ended December 31, 2010, 2011 and 2012, was \$ 1.96, \$ 2.69 and \$ 1.35 per share, respectively, using the Black-Scholes option pricing formula. Fair values were estimated using the following weighted-average assumptions (annualized percentages):

	<b>Year ended December 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Dividend yield	0%	0%	0%
Expected volatility	48.68%-53.2%	53.5%-59.6%	56.6%-61.5%
Risk-free interest	1.02%-2.46%	0.8%-2.04%	0.54%-1.04%
Expected life	4.67-5.69 years	4.67-5.69 years	4.79-5.70 years
Forfeiture rate	10.0%	10.0%	5.5%

The Company used its historical volatility in accordance with ASC 718. The computation of volatility uses historical volatility derived from the Company's exchange traded shares. The expected term of options granted is estimated based on historical experience and represents the period of time that options granted are expected to be outstanding. The risk free interest rate assumption is the implied yield currently available on United States treasury zero-coupon issues with a remaining term equal to the expected life of the Company's options. The dividend yield assumption is based on the Company's historical experience and expectation of no future dividend payouts and may be subject to substantial change in the future. The Company has historically not paid cash dividends and has no foreseeable plans to pay cash dividends in the future.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

The total equity-based compensation expenses relating to all of the Company's equity-based awards recognized for the years ended December 31, 2010, 2011 and 2012 were included in items of the consolidated statements of income as follows:

	Year ended December 31,		
	2010	2011	2012
Cost of revenues	\$ 62	\$ 130	\$ 61
Research and development expenses, net	393	526	430
Selling and marketing expenses	1,180	964	437
General and administrative expenses	453	703	601
Total equity-based compensation expenses	<u>\$ 2,088*)</u>	<u>\$ 2,323</u>	<u>\$ 1,529</u>

\*) Also includes equity-based compensation that was classified as a liability.

## v. Treasury stock:

The Company has repurchased its ordinary shares from time to time in the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity. See also Note 13a.

## w. Severance pay:

The liability for severance pay for 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 for all employees in Israel. Employees who have been employed for more than one year period, are entitled to one month's salary for each year of employment, or a portion thereof. The Group's liability for all of its Israeli employees is fully provided for by monthly deposits with severance pay funds, insurance policies and by an accrual. The value of these deposits is recorded as an asset in the Company's balance sheet.

The deposited funds include profits accumulated 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

---

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

Since March 2011, the Company's agreements with new employees in Israel are under Section 14 of the Severance Pay Law, 1963. The Company's contributions for severance pay have replaced its severance obligation. Upon contribution of the full amount of the employee's monthly salary for each year of service, no additional calculations are conducted between the parties regarding the matter of severance pay and no additional payments are made by the Company to the employee. Further, the related obligations and amounts deposited on behalf of the employee for such obligations are not stated on the balance sheet, as the Company is legally released from the obligations to employees once the deposit amounts have been paid.

Severance pay expenses for the years ended December 31, 2010, 2011 and 2012, amounted to \$ 1,733, \$ 2,162 and \$ 1,850, respectively.

x. Employee benefit plan:

The Group has 401(k) defined contribution plans covering employees in the U.S. All eligible employees may elect to contribute a portion of their annual compensation to the plan through salary deferrals, subject to the IRS limit of \$ 16.5 and \$ 17 during the years ended December 31, 2011 and 2012, respectively, plus a catch-up contribution of \$ 5.5 for participants age 50 or over. The group matches 50% of employees contributions, up to a maximum of 6% of the employees annual pay. In the years ended December 31, 2010, 2011 and 2012, the Group matched contributions in the amount of \$ 240, \$ 301 and \$ 276, respectively.

y. Advertising expenses:

Advertising expenses are charged to the statements of operations as incurred. Advertising expenses for the years ended December 31, 2010, 2011 and 2012 amounted to \$ 374, \$ 442 and \$ 329, respectively.

z. Fair value of financial instruments:

The estimated fair value of financial instruments has been determined by the Group using available market information and valuation methodologies. Considerable judgment is required in estimating fair values. Accordingly, the estimates may not be indicative of the amounts the Company could realize in a current market exchange.

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

The carrying amounts of cash and cash equivalents, short-term bank deposits, trade receivables, trade payables, other receivables and other payables approximate their fair value due to the short-term maturity of such instruments. The fair value of long-term bank loans and senior convertible loans also approximates their carrying value, since they bear interest at rates close to the prevailing market rates.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

The fair value of foreign currency contracts is estimated by obtaining current quotes from banks and market observable data of similar instruments.

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, ASC 820, "Fair Value Measurements and Disclosures" establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets
- Level 2 - Observable inputs, other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data
- Level 3 - Unobservable inputs which are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs

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. See also Note 8.

aa. Derivatives and hedging:

The Group accounts for derivatives and hedging based on ASC 815, "Derivatives and Hedging".

The Group accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivative instruments that are not designated and qualified as hedging instruments must be adjusted to fair value through earnings. The changes in fair value of such instruments are included as earnings in "Financial income (expenses)" at each reporting period.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (loss) in equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is classified as payroll and rent expenses. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings and classified as financial income or expenses. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions.

During the year ended December 31, 2011, the Group recorded accumulated other comprehensive loss in the amount of \$ 1,062 from its forward exchange contracts with respect to payroll and rent expenses expected to be incurred during the year ended December 31, 2012. Such amount was reclassified into earnings during the year ended December 31, 2012.

During the year ended December 31, 2012, the Group recorded accumulated other comprehensive income in the amount of \$ 1,543 from its forward and options collar (cylinder) contracts with respect to payroll expenses expected to be incurred during the year ending December 31, 2013. Such amount will be reclassified into earnings during the year ending December 31, 2013. See also Note 18.

ab. Impact of recently issued accounting pronouncements:

In February 2013, the FASB issued ASU. 2013-02, Topic 350, "Comprehensive Income", which amends Topic 220 to improve the reporting of reclassifications out of accumulated other comprehensive income to the respective line items in net income. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012. The Company intends to adopt this standard in 2013 and does not expect the adoption will have a material impact on its consolidated results of operations or financial condition.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 3:- MARKETABLE SECURITIES AND ACCRUED INTEREST**

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

	<b>December 31, 2011</b>			
	<b>Amortized cost</b>	<b>Gross Unrealized gains</b>	<b>Gross Unrealized losses</b>	<b>Fair Value</b>
Corporate debentures - Maturing between one to three Years	\$ 23,823	\$ 46	\$ (736)	\$ 23,133
Accrued interest	345	-	-	345
	<u>\$ 24,168</u>	<u>\$ 46</u>	<u>\$ (736)</u>	<u>\$ 23,478</u>
	<b>December 31, 2012</b>			
	<b>Amortized cost</b>	<b>Unrealized gains</b>	<b>Fair Value</b>	
Corporate debentures:				
Maturing within one year	\$ 7,625	\$ 62	\$ 7,687	
Maturing between one to two years	15,762	299	16,061	
Accrued interest	341	-	341	
	<u>\$ 23,728</u>	<u>\$ 361</u>	<u>\$ 24,089</u>	

These investments were issued by highly rated corporations. Accordingly, it was expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. As of December 31, 2011 and 2012, the Group did not have any investment in marketable securities that was in an unrealized loss position for a period of twelve months or greater. Since the Company had the ability and intent to hold these investments until an anticipated recovery of fair value, which may be until maturity, the Company did not consider these investments to be other-than-temporarily impaired as of December 31, 2011 and 2012. Unrealized gains (losses) are valued using alternative pricing sources and models utilizing observable market inputs.

**NOTE 4:- INVENTORIES**

	<b>December 31,</b>	
	<b>2011</b>	<b>2012</b>
Raw materials	\$ 8,871	\$ 7,684
Finished products	11,544	9,113
	<u>\$ 20,415</u>	<u>\$ 16,797</u>

In the years ended December 31, 2010, 2011 and 2012, the Group wrote-off inventories in a total amount of \$ 1,113, \$ 644 and \$ 2,306, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 5:- INVESTMENT IN AN AFFILIATED COMPANY**

As of December 31, 2011 and 2012, the Company owned 26.6% and 26.4%, respectively, of MailVision's outstanding share capital.

	<b>December 31,</b>	
	<b>2011</b>	<b>2012</b>
Invested in equity	\$ 1,655	\$ 1,655
Convertible and non-convertible loans	211	398
Accumulated net loss	(615)	(969)
<b>Total investment</b>	<b>\$ 1,251</b>	<b>\$ 1,084</b>

Balances and transactions with MailVision were as follows:

## a. Balances:

	<b>December 31,</b>	
	<b>2011</b>	<b>2012</b>
Other receivables and prepaid expenses	\$ 116	\$ -
Other payables and accrued expenses	\$ -	\$ 492

## b. Transactions:

	<b>Year ended December 31,</b>		
	<b>2011</b>	<b>2012</b>	<b>2012</b>
Amounts charged - cost of revenues	\$ 417	\$ 2,164	\$ 1,414

As described in Note 19, in April 2013, the Company entered into an asset purchase agreement with MailVision.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6:- PROPERTY AND EQUIPMENT

	December 31,	
	2011	2012
Cost:		
Computers and peripheral equipment	\$ 21,844	\$ 23,463
Office furniture and equipment	10,299	10,652
Leasehold improvements	2,302	2,336
	<u>34,445</u>	<u>36,451</u>
Accumulated depreciation:		
Computers and peripheral equipment	20,305	21,556
Office furniture and equipment	9,169	9,473
Leasehold improvements	1,603	1,803
	<u>31,077</u>	<u>32,832</u>
Depreciated cost	<u>\$ 3,368</u>	<u>\$ 3,619</u>

Depreciation expenses amounted to \$ 2,822, \$ 1,914 and \$ 1,755 for the years ended December 31, 2010, 2011 and 2012, respectively.

## NOTE 7:- INTANGIBLE ASSETS, DEFERRED CHARGES

	Useful life (years)	December 31,	
		2011	2012
a. Impaired Cost:			
Acquired technology	5-10	\$ 15,517	\$ 15,517
Customer relationship	9	4,172	4,172
Trade name	3	415	415
Existing contracts for maintenance	3	181	181
		<u>20,285</u>	<u>20,285</u>
Accumulated amortization:			
Acquired technology		12,575	13,399
Customer relationship		3,129	3,433
Trade name		415	415
Existing contracts for maintenance		181	181
		<u>16,300</u>	<u>17,428</u>
Amortized cost		<u>\$ 3,985</u>	<u>\$ 2,857</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 7:- INTANGIBLE ASSETS, DEFERRED CHARGES (Cont.)**

- b. Amortization expenses related to intangible assets amounted to \$ 1,537, \$ 1,325 and \$ 1,128 for the years ended December 31, 2010, 2011 and 2012, respectively.
- c. Expected amortization expenses are as follows:

Year ending December 31,	
2013	\$ 930
2014	\$ 872
2015	\$ 696
2016	\$ 359
	<u>\$ 2,857</u>

**NOTE 8:- FAIR VALUE MEASUREMENTS**

In accordance with ASC No. 820, "Fair Value Measurements and Disclosures", the Group measures its foreign currency derivative instruments and the contingent consideration to NSC's former shareholders at fair value. Foreign currency derivative contracts are classified within Level 2 value hierarchy. This is because these instruments are valued using alternative pricing sources and models utilizing market observable inputs. The contingent consideration to NSC's former shareholders is classified within Level 3 value hierarchy because the liability is based on present value calculations and external valuation models whose inputs include market interest rates, estimated operational capitalization rates, volatilities and illiquidity. Unobservable inputs used in these models are significant.

The Group's financial assets and liabilities measured at fair value on a recurring basis, consisted of the following types of instruments as of the following dates:

	<b>December 31, 2011</b>		
	<b>Fair value measurements using input type</b>		
	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Foreign currency derivative contracts	\$ (361)	\$ -	\$ (361)
Contingent consideration related to NSC's former shareholders	-	(412)	(412)
Total financial liabilities	<u>\$ (361)</u>	<u>\$ (412)</u>	<u>\$ (773)</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 8:- FAIR VALUE MEASUREMENTS (Cont.)**

	<b>December 31, 2012</b>		
	<b>Fair value measurements using input type</b>		
	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Financial assets related to foreign currency derivative hedging contracts	\$ 1,303	\$ -	\$ 1,303
Foreign currency derivative contracts	\$ (362)	-	\$ (362)
Contingent consideration related to NSC's former shareholders	-	(115)	(115)
Total Financial liability	\$ (362)	\$ (115)	\$ (477)

Fair value measurements using significant unobservable inputs (Level 3):

Balance at January 1, 2012	\$ (412)
Adjustments due to change in estimates	364
Adjustment due to time change value	(67)
Balance at December 31, 2012	\$ (115)

**NOTE 9:- OTHER PAYABLES AND ACCRUED EXPENSES**

	<b>December 31,</b>	
	<b>2011</b>	<b>2012</b>
Vacation accrual	\$ 3,030	\$ 2,476
Royalties provision	517	420
Other employees and payroll accruals	3,879	3,542
Government authorities	574	385
Accrued expenses	9,596	7,877
Others	506	362
	\$ 18,102	\$ 15,062

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 10:- SENIOR CONVERTIBLE NOTES**

In November 2004, the Company issued an aggregate of \$ 125,000 principal amount of its 2% Senior Convertible Notes due November 9, 2024 ("the Notes"). The Company is obligated to pay interest on the Notes semi-annually on May 9 and November 9 of each year.

The Notes are convertible, at the option of the holders, at any time before the maturity date, into ordinary shares of the Company at a conversion rate of 53.4474 ordinary shares per \$ 1 principal amount of Notes, representing a conversion price of approximately \$ 18.71 per share. Upon such conversion in lieu of the delivering of ordinary shares, the Company may elect to pay the holders cash or a combination of cash and ordinary shares. The Notes are subject to redemption at any time on or after November 9, 2009, in whole or in part, at the option of the Company, at a redemption price of 100% of the principal amount plus accrued and unpaid interest. The Notes are subject to repurchase, at the holders' option, on November 9, 2009, November 9, 2014 or November 9, 2019, at a repurchase price equal to 100% of the principal amount plus accrued and unpaid interest, if any, on such repurchase date. The Company may choose to settle in cash upon conversion. The holders of almost all of the principal amount of the Notes outstanding in November, 2009 elected to have the Company repurchase the Notes held by them.

During the year ended December 31, 2010, the Company repurchased \$ 50, in principal amount of the Notes for a total cost, including accrued interest, of \$ 50. As of December 31, 2011 and 2012, there was \$ 353 in principal amount of the Notes outstanding. The effective interest rate for the years ended December 31, 2010, 2011 and 2012 amounted to 2% per year.

**NOTE 11:- LONG-TERM BANK LOANS**

In April and July 2008, the Company entered into loan agreements with Israeli commercial banks that provided for loans in the total principal amount of \$ 30,000 ("the 2008 Loans"). The 2008 Loans bear interest at LIBOR plus 1.3%-1.5% with respect to \$ 23,000 of the principal amount of the 2008 Loans and LIBOR plus 0.5%-0.65% with respect to the remaining \$ 7,000 of principal amount of the 2008 Loans. The principal amount is repayable in 20 equal quarterly payments through July 2013.

In September and December 2011, the Company entered into loan agreements with Israeli commercial banks that provided for loans in the total principal amount of \$ 23,750 ("the 2011 Loans"). The 2011 Loans bear interest at LIBOR plus 2.1%-4.35% with respect to \$ 19,850 of the principal amount of the 2011 Loans. The remaining \$ 3,900 of principal amount of the 2011 Loans was required to be maintained as a compensating bank deposit that decreases as the loans are repaid. This portion of the 2011 Loans bear interest at 0.5% above the interest rate paid on the bank deposit. Of these 2011 Loans, \$ 19,850 of the principal amount is repayable in 20 equal quarterly installments and the remaining \$3,900 of principal amount is repayable in 10 equal semiannual payments through September 2017.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 11:- LONG-TERM BANK LOANS (Cont.)**

As of December 31, 2011 and 2012, the banks have a lien on the Company's assets that secures both the 2008 and the 2011 Loans. As of December 31, 2011 and 2012, the Company is required to maintain a total of \$ 16,450 and \$ 13,456, respectively, in compensating balances with the banks, to secure the 2008 and the 2011 Loans. As of December 31, 2011 and 2012, the compensating balances are included in \$ 7,630 and \$ 4,205 of short-term and restricted bank deposits and \$ 8,820 and \$ 9,251 of long-term and restricted bank deposits, respectively. The amount of the compensation balances are allowed to be decreased as the Company repays these loans. The agreements with respect to the 2008 and the 2011 Loans require the Company, among other things, to meet certain financial covenants as to maintaining shareholders' equity, cash balances and liabilities to banks at specified levels and achieving certain levels of operating income.

As of December 31, 2012, the Company was in compliance with its covenants to the banks except for the requirement to achieve certain minimum operating income. The Company received waivers from the banks with respect to these covenants until December 31, 2013, subject to compliance with revised financial covenants in 2012 and 2013, an increase in the interest rate with respect to one of the loans and an increase in required compensating balances. As of December 31, 2012, the Company was in compliance with the revised financial covenants and also expects to be in compliance with these covenants by the end of the waiver period.

**NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES**

## a. Lease commitments:

The Group's facilities are rented under several lease agreements in Israel, Europe and the U.S. for periods ending in 2017.

Future minimum rental commitments under non-cancelable operating leases, are as follows:

**Year ending December 31,**

2013	\$	5,375
2014		5,231
2015		4,991
2016		5,179
2017		4,748
<b>Total minimum lease payments *)</b>	<b>\$</b>	<b>25,524</b>

\*) Minimum payments have been reduced by minimum sublease rental of \$ 1,399 due in the future under non-cancelable subleases.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

In connection with the Company's offices lease agreement in Israel, the lessor has a lien of approximately \$ 5,000 which is included in short-term and restricted bank deposits.

Rent expenses for the years ended December 31, 2010, 2011 and 2012, were approximately \$ 4,790, \$ 5,327 and \$ 5,745, respectively.

b. Inventory purchase commitments:

The Group is obligated under certain agreements with its suppliers to purchase specified items of excess inventory which is expected to be utilized in 2013. As of December 31, 2012, non-cancelable obligations were approximately \$ 1,174.

c. Royalty commitment to the Office of the Chief Scientist in Israel ("OCS"):

Under the research and development agreements of the Company and its Israeli subsidiaries with the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3%-5% of sales to the end customer of products developed with funds provided by the OCS, up to an amount equal to 100% of the OCS research and development grants received, linked to the dollar plus interest on the unpaid amount received based on the 12-month LIBOR rate (from the year the file has been approved) applicable to dollar deposits. The Company is obligated to repay the Israeli Government for the grants received only to the extent that there are sales of the funded products.

The place of manufacturing of a product that was developed with the support of the OCS, or based on know-how developed with the support of the OCS, shall be according to the supported company's declaration in the application for support (including manufacturing abroad). In case a company wishes to transfer manufacturing activity abroad, additional to its statement in the application for support, it will be required to receive approval from the OCS research committee. The committee is entitled to increase both the royalty liability and the rate of the royalty payments. The increased repayment is calculated according to the percentage of the manufacturing activities that are intended to be carried out outside Israel, and can reach up to 300% of the original sum. When the manufacturing of the product is being done outside of Israel, the Company is required to pay an increased royalty rate of an additional 1% (instead of paying 3%-5%, the Company would pay 4%-6%).

As of December 31, 2011 and 2012, the Company and its Israeli subsidiaries have a contingent obligation to pay royalties in the amount of approximately \$ 24,062 and \$ 29,413, respectively.

As of December 31, 2011 and 2012, the Company and its Israeli subsidiaries have paid or accrued royalties to the OCS in the amount of \$1,475 and \$ 1,810, respectively, which were recorded in cost of revenues.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

## d. Royalty commitments to third parties:

The Group has entered into technology licensing fee agreements with third parties. Under the agreements, the Group agreed to pay the third parties royalties, based on sales of relevant products. See also Note 9.

## e. Legal proceedings:

1. The Group's major customer in 2008 and 2009 filed an action asserting that the Group received approximately \$ 3.2 million in payments from them during the ninety day period prior to their bankruptcy filing in January 2009 that constitute avoidable preferential transfers. The parties have settled the matter pursuant to the Stipulation of Settlement of Avoidance Claims and Recoupment of Claims ("the Stipulation"). Under the Stipulation, the Company paid \$ 20 to the customer and all claims by the parties have been released and withdrawn. In July 2012, the Court entered an order approving the Stipulation and the adversary proceeding was closed on August 1, 2012.
2. In May 2007, the Company entered into an agreement with respect to property adjacent to its headquarters in Israel, pursuant to which a building of approximately 145,000 square feet has been erected and was expected to be leased to the Company for a period of eleven years. This new building was substantially completed in May 2010. The landlord claimed that the Company should have taken delivery of the building at that time and started paying rent. The Company disagreed with the landlord's interpretation of the relevant agreement. As a result, the landlord terminated the agreement and leased the property to a third party. This dispute has been referred to arbitration where the Company claims that due to the landlord's failure the Company lost significant potential revenues. The landlord counterclaimed alleging that it sustained losses equal to approximately one year's rent and management fees in the aggregate amount of approximately NIS 14 million (approximately \$ 3,750). The Company believes that it has valid defenses to the counterclaim and a provision is not required.
3. In September 2011, an action was commenced against the Company's subsidiary, AudioCodes Inc. and numerous other defendants, in Federal Court in Delaware alleging that AudioCodes Inc. and the other defendants, infringed the plaintiff's intellectual property rights in five patents. The claims made in this action are being defended by AudioCodes Inc. The Court granted the defendants' motion for summary judgment of invalidity on one of the patents, dismissing all claims of infringement based on this patent. Plaintiff continues to maintain its action against AudioCodes Inc. and certain other defendants based on alleged infringement of four other patents that were not dismissed from the action. Preliminary discovery has begun, but it is not possible to predict the outcome of this proceeding. The Company believes it has valid defenses to the claims and a provision is not required.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

4. In November 2011, an action was commenced against AudioCodes Inc., in Federal Court in Texas alleging that AudioCodes Inc. infringed the plaintiff's intellectual property rights in one patent. All claims asserted in this action were dismissed without prejudice by the court on May 15, 2012.
5. In January 2013, one of the Company's former senior executives sent a letter of demand claiming an amount of approximately \$ 1,000 relating to his termination of employment. The Company has denied all of his allegations and believes that it has valid defenses to this claim.
6. In February 2013, a patent infringement action was commenced against AudioCodes Inc. and other defendants, in Federal Court in California alleging that AudioCodes Inc. infringed the plaintiff's intellectual property rights in one patent. One of the other defendants is a customer of the Company that has informed that it believes it is entitled to indemnification from the Company with respect to this litigation. The proceedings are at an early stage and it is not possible at this time to predict their outcome. The Company believes it has valid defenses against the claims.

**NOTE 13:- EQUITY**

## a. Treasury stock:

In October 2011, the Company's Board of Directors approved a share repurchase plan pursuant to which the Company was authorized to purchase up to 4,000,000 of its outstanding ordinary shares. During the year ended December 31, 2011 and 2012, the Company purchased 1,204,757 and 2,759,594 of its outstanding ordinary shares under this share repurchase plan, at a weighted average price per share of \$ 3.33 and \$ 2.44, respectively. As of October 2012, the authorized stock repurchase program was completed.

## b. Warrants issued to nonemployees:

During the years ended December 31, 2010, 2011 and 2012, the Company granted warrants to purchase 25,000, 2,500 and 4,000 shares at a weighted average exercise price of \$ 2.92, \$ 3.57 and \$ 3.89 per share, respectively, in each case expiring seven years from the date of grant. The Company recorded immaterial compensation expenses with respect to the grants of these warrants in accordance with ASC 505. During the year ended December 31, 2010, 5,000 warrants were exercised and during the year ended December 31, 2012, 10,000 warrants were forfeited. As of December 31, 2011 and 2012, 32,500 and 26,500 warrants issued to consultants are outstanding, out of which 17,500 and 22,500 warrants are exercisable, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 13:- EQUITY (Cont.)**

## c. Employee Stock Purchase Plan:

In May 2001, the Company's Board of Directors adopted the Employee Stock Purchase Plan ("ESPP" or "the Purchase Plan"), which was amended, in July 2007. The Purchase Plan, as amended, provides for the issuance of up to 6,500,000 ordinary shares. As of December 31, 2011, 1,761,317 shares were available for future issuance under the Purchase Plan. Eligible employees can have up to 10% of their wages, up to certain maximums, used to purchase ordinary shares. The Purchase Plan is implemented with purchases every six months. The price of the ordinary shares purchased under the

Purchase Plan is equal to 85% of the lower of the fair market value of the ordinary shares on the commencement date of each offering period or on the semi-annual purchase date. The Purchase Plan is considered a compensatory plan. Therefore, the Company records compensation expense in accordance with ASC 718, "Compensation - Stock Compensation", with respect to purchases under the Purchase Plan.

During the year ended December 31, 2011, 288,515 shares were issued under the Purchase Plan for aggregate consideration of \$ 1,187. As of December 31, 2011 and 2012, the Company's Board of Directors decided to suspend the Purchase Plan for the employees of the Company's U.S subsidiary and the Purchase Plan for the Company and its non-U.S subsidiaries has expired.

## d. Employee Stock Option Plans:

In the year ended December 31, 2008, the Company's Board of Directors approved the 2008 Equity Incentive Plan that became effective in January 2009. As of December 31, 2012, the total number of shares authorized for grant under this Plan is 660,979.

Stock options granted under the abovementioned plan are exercisable at the fair market value of the ordinary shares at the date of grant and usually expire seven or ten years from the date of grant. The options generally vest over four years from the date of grant. Any options that are forfeited or cancelled before expiration become available for future grants.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 13:- EQUITY (Cont.)

The following is a summary of the Company's stock option activity and related information for the year ended December 31, 2012:

	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at beginning of year	3,894,556	\$ 6.10	4.2	\$ 1,824
Changes during the year:				
Granted	927,376	\$ 2.66		
Exercised	(52,125)	\$ 1.97		
Forfeited	(540,375)	\$ 6.72		
Expired	(452,400)	\$ 10.16		
Options outstanding at end of year	<u>3,777,032</u>	<u>\$ 4.74</u>	<u>4.0</u>	<u>\$ 1,477</u>
Vested and expected to vest	<u>3,569,295</u>	<u>\$ 4.74</u>	<u>4.0</u>	<u>\$ 1,396</u>
Options exercisable at end of year	<u>2,098,152</u>	<u>\$ 5.85</u>	<u>2.5</u>	<u>\$ 753</u>

The weighted-average grant-date fair value of options granted during the years ended December 31, 2010, 2011 and 2012 was \$ 1.96, \$ 2.69 and \$ 1.35, 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 the fiscal year 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 the last trading day of the fiscal year. This amount changes based on the fair market value of the Company's shares.

Total intrinsic value of options exercised for the years ended December 31, 2010, 2011 and 2012 was \$ 2,946, \$ 44 and \$ 63, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 13:- EQUITY (Cont.)

The options outstanding as of December 31, 2012, have been separated into ranges of exercise prices, as follows:

Range of exercise price	Options outstanding as of December 31, 2012	Weighted average remaining contractual life (Years)	Weighted average exercise price	Options exercisable as of December 31, 2012	Weighted average exercise price of exercisable options
\$ 0.00-1.10	50,816	4.53	\$ 0.01	49,691	\$ 0.01
\$ 1.50-2.51	751,625	4.34	\$ 2.03	420,875	\$ 2.09
\$ 2.57-4.00	1,377,885	5.79	\$ 3.04	337,649	\$ 3.06
\$ 4.08-6.49	842,956	3.16	\$ 5.51	634,812	\$ 5.57
\$ 6.51-9.24	153,750	4.52	\$ 7.30	55,125	\$ 7.13
\$ 9.32-14.76	600,000	0.56	\$ 10.70	600,000	\$ 10.70
	<u>3,777,032</u>	4.0	<u>\$ 4.74</u>	<u>2,098,152</u>	<u>\$ 5.85</u>

The following is a summary of the Company's restricted share units ("RSUs") activity and related information for the year ended December 31, 2012:

	Number of shares	Weighted average grant date fair value
Outstanding at beginning of year	264,684	\$ 4.89
Changes during the year:		
Granted	70,215	\$ 2.73
Exercised	(120,488)	\$ 4.97
Forfeited	<u>(32,250)</u>	<u>\$ 6.10</u>
RSUs outstanding at end of year	<u>182,161</u>	<u>\$ 3.79</u>

During the years ended December 31, 2010, 2011 and 2012, the share based compensation expenses related to the RSUs granted amounted to \$ 678, \$ 786 and \$ 435, respectively.

As of December 31, 2012, there was \$ 2,020 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 1.08 years.

## e. Dividends:

In the event that cash dividends are declared in the future, such dividends will be paid in NIS. The Company does not intend to pay cash dividends in the foreseeable future. (See also Note 14a.)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME**

## a. Israeli taxation:

## 1. Measurement of taxable income:

The Company has elected to measure its taxable income and file its 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. Accordingly, results for tax purposes are measured in terms of earnings in dollars.

## 2. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 ("the Investment Law"):

The Company's production facilities in Israel have been granted the status of an "Approved Enterprise" in accordance with the Investment Law under four separate investment programs. According to the provisions of such Israeli Investment Law, the Company has been granted the "Alternative Benefit Plan", under which the main benefits are tax exemptions and reduced tax rates.

Therefore, the Company's income derived from the Approved Enterprise will be entitled to a tax exemption for a period of two years and to an additional period of five to eight years of reduced tax rates of 10% - 25% (based on the percentage of foreign ownership). The duration of tax benefits of reduced tax rates is subject to a limitation of the earlier of 12 years from commencement of production, or 14 years from the approval date. The Company utilized tax benefits from the first program in 1998 and has been no longer eligible for benefits since 2007.

As of December 31, 2012, retained earnings included approximately \$ 540 in tax-exempt income earned by the Company's "Approved Enterprise". The Company's Board of Directors has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

Tax-exempt income attributable to the "Approved Enterprise" cannot be distributed to shareholders without subjecting the Company to taxes.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME (Cont.)**

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above Investment 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 canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2012, management believes that the Company is in compliance with all of the aforementioned conditions.

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular tax rate prevailing at that time.

On April 1, 2005, an amendment to the Investment Law came into effect ("the 2005 Amendment") that significantly changed the provisions of the Investment Law. The 2005 Amendment limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as a Beneficiary Enterprise including a provision generally requiring that at least 25% of the Beneficiary Enterprise's income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investment Law as they were on the date of such approval. Therefore, the Company's existing "Approved Enterprises" are generally not subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the Investment Law, as amended, 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. As of December 31, 2012, there was no taxable income attributable to the Beneficiary Enterprise.

In December 2010, an amendment to the Investment Law came into effect ("the 2010 Amendment"). The 2010 Amendment became effective as of January 1, 2011. According to the 2010 Amendments, the benefit tracks in the Investment Law were modified and a flat tax rate applies to the Company's entire preferred income. The Company can elect to have the 2010 Amendment apply to it. Once an election is made, the Company will be subject to the amended tax rates as follows: 2011 and 2012 - 15%, 2013 and 2014 - 12.5% and in 2015 and thereafter - 12%.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME (Cont.)**

The Company does not currently intend to implement the 2010 Amendment, and intends to continue to comply with the Investment Law as in effect prior to enactment of the 2010 Amendment.

3. Net operating loss carry forward:

As of December 31, 2012, the Company has cumulative losses for tax purposes in the amount of approximately \$ 25,000, which can be carried forward and offset against taxable income in the future for an indefinite period. As of December 31, 2012, the Company recorded a deferred tax asset of \$ 3,704 in respect of such carry forward tax losses, since it believes it is more likely than not it will utilize carry forward tax losses.

As of December 31, 2012, the Company's Israeli subsidiaries have estimated total available carry forward tax losses of approximately \$ 67,000. The net operating losses may be claimed and offset against taxable income in the future for an indefinite period.

4. Tax benefits under the law for the Encouragement of Industry (taxes), 1969 ("the Encouragement Law"):

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

Management believes that the Company is currently qualified as an "industrial company" under the Encouragement Law and, as such, enjoys tax benefits, including: (1) deduction of purchase of know-how and patents and/or right to use a patent over an eight-year period; (2) the right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies and an industrial holding company; (3) accelerated depreciation rates on equipment and buildings; and (4) expenses related to a public offering on the Tel-Aviv Stock Exchange and on recognized stock markets outside of Israel, are deductible in equal amounts over three years.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME (Cont.)**

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

## 5. Tax rates:

Taxable income of Israeli companies is subject to tax at the rate of 25%, 24% and 25% in the years ended December 31, 2010, 2011 and 2012, respectively.

On December 5, 2011, the Israeli Parliament (the Knesset) enacted the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

The effective tax rate payable by a company which is taxed under the Investment Law may be considerably lower (see also Note 14 a2).

## b. Income (loss) before taxes on income is comprised as follows:

	<b>Year ended December 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Domestic	\$ 9,277	\$ 5,632	\$ (2,555)
Foreign	1,066	2,047	(727)
	<u>\$ 10,343</u>	<u>\$ 7,679</u>	<u>\$ (3,282)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 14:- TAXES ON INCOME (Cont.)

c. Taxes on income are comprised as follows:

	Year ended December 31,		
	2010	2011	2012
Current taxes	\$ 436	\$ 890	\$ 527
Deferred taxes	(2,321)	(652)	14
	<u>\$ (1,885)</u>	<u>\$ 238</u>	<u>\$ 541</u>
Domestic	\$ (1,617)	\$ 151	\$ 283
Foreign	(268)	87	258
	<u>\$ (1,885)</u>	<u>\$ 238</u>	<u>\$ 541</u>

d. Deferred income taxes:

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

	December 31,	
	2011	2012
Deferred tax assets:		
Net operating loss carry forward	\$ 50,413	\$ 52,035
Reserves and allowances	8,283	7,016
Net deferred tax assets before valuation allowance	58,696	59,051
Valuation allowance	(53,496)	(53,865)
Deferred tax asset	<u>\$ 5,200</u>	<u>\$ 5,186</u>
Domestic:		
Short-term deferred tax asset	\$ 1,857	\$ 1,157
Long-term deferred tax asset	1,857	2,547
	<u>\$ 3,714</u>	<u>\$ 3,704</u>
Foreign:		
Short-term deferred tax asset	\$ 743	\$ 463
Long-term deferred tax asset	743	1,019
	<u>\$ 1,486</u>	<u>\$ 1,482</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME (Cont.)**

The Company's U.S. subsidiary has estimated total available carry forward tax losses of approximately \$ 84,000 to offset against future taxable income. These carry forward tax losses expire between 2020 and 2032. As of December 31, 2012, the Company's U.S subsidiary recorded a deferred tax asset of \$ 1,482 relating to the available net carry forward tax losses.

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 provisions. The annual limitation may result in the expiration of net operating losses before utilization.

## e. Reconciliation of the theoretical tax expenses:

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 (benefit) as reported in the statement of operations is as follows:

	Year ended December 31,		
	2010	2011	2012
Income (loss) before taxes, as reported in the consolidated statements of operations	\$ 10,343	\$ 7,679	\$ (3,282)
Statutory tax rate	25%	24%	25%
Theoretical tax expense (benefit) on the above amount at the Israeli statutory tax rate	\$ 2,586	\$ 1,843	\$ (821)
Income tax at rate other than the Israeli statutory tax rate	327	275	(55)
Tax advances, withholding tax and non-deductible expenses, including equity based compensation expenses	646	1,373	807
Deferred taxes on losses for which a valuation allowance was provided	(3,855)	2,416	369
Valuation allowance recorded to APIC	181	(266)	386
Utilization of operating losses carry forward	(2,846)	(3,233)	-
Tax adjustment in respect of different tax rates	-	(1,219)	-
Taxes in respect to prior years	41	(54)	(162)
State and Federal taxes	90	93	48
Foreign exchange	760	(901)	89
Other	185	(89)	(120)
Actual tax expense (benefit)	\$ (1,885)	\$ 238	\$ 541

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 14:- TAXES ON INCOME (Cont.)**

- f. A reconciliation of the beginning and ending amount of unrecognized tax benefits in the year ended December 31, 2012 is as follows:

Gross unrecognized tax benefits as of January 1, 2012	\$ 190
Increase in tax position for current year	<u>8</u>
Gross unrecognized tax benefits as of December 31, 2012	<u>\$ 198</u>

The Company recognizes interest and penalties related to unrecognized tax benefits in tax expenses in the amount of \$ 16, \$ 9 and \$ 7 for the years ended at December 31, 2010, 2011 and 2012, respectively. The liability for unrecognized tax benefits does not include the liability recorded for accrued interest and penalties of \$ 189 and \$ 196 at December 31, 2011 and 2012, respectively.

The Company has received final tax assessment through the year 2006.

**NOTE 15:- BASIC AND DILUTED NET EARNINGS (LOSS) PER SHARE**

	Year ended December 31,		
	2010	2011	2012
<b>Numerator:</b>			
Net income (loss) attributed to Audiocodes' shareholders	<u>\$ 12,126</u>	<u>\$ 7,164</u>	<u>\$ (4,177)</u>
<b>Denominator:</b>			
Denominator for basic earnings per share - weighted average number of ordinary shares, net of treasury stock	40,559,759	41,437,927	39,125,129
Effect of dilutive securities:			
Employee stock options and ESPP	401,240	497,170	-*)
Senior convertible notes	-*)	-*)	-*)
Denominator for diluted net earnings per share - adjusted weighted average number of shares	<u>40,960,999</u>	<u>41,935,097</u>	<u>39,125,129</u>

\*) Antidilutive.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 16:- FINANCIAL INCOME (EXPENSES), NET**

	Year ended December 31,		
	2010	2011	2012
Financial expenses:			
Interest	\$ (318)	\$ (346)	\$ (900)
Amortization of marketable securities premiums and accretion of discounts, net	-	(416)	(436)
Exchange rate	(99)	(612)	(4)
Others	(228)	(133)	(201)
	<u>(645)</u>	<u>(1,507)</u>	<u>(1,541)</u>
Financial income -			
Interest and others	551	1,930	1,994
	<u>\$ (94)</u>	<u>\$ 423</u>	<u>\$ 453</u>

**NOTE 17:- GEOGRAPHIC INFORMATION**

- a. Summary information about geographic areas:

The Group manages its business on a basis of one reportable segment (see Note 1 for a brief description of the Group's business). The data is presented in accordance with ASC 280, "Segment Reporting". Revenues in the table below are attributed to geographical areas based on the location of the end customers.

The following presents total revenues for the years ended December 31, 2010, 2011 and 2012 and long-lived assets as of December 31, 2010, 2011 and 2012.

	2010		2011		2012	
	Total revenues	Long-lived assets	Total revenues	Long-lived assets	Total revenues	Long-lived assets
Israel	\$ 19,223	\$ 19,867	\$ 11,887	\$ 19,364	\$ 7,773	\$ 19,450
Americas	71,538	21,128	85,630	19,914	66,443	18,959
Europe	32,566	66	36,322	125	35,876	119
Far East	26,713	47	21,988	45	17,398	43
	<u>\$ 150,040</u>	<u>\$ 41,108</u>	<u>\$ 155,827</u>	<u>\$ 39,448</u>	<u>\$ 127,490</u>	<u>\$ 38,571</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 17:- GEOGRAPHIC INFORMATION (Cont.)**

## b. Product lines:

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	<b>Year ended December 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Technology	\$ 45,266	\$ 35,017	\$ 24,673
Networking	104,774	120,810	102,817
	<u>\$ 150,040</u>	<u>\$ 155,827</u>	<u>\$ 127,490</u>

**NOTE 18:- DERIVATIVE INSTRUMENTS**

The Group enters into hedge transactions with a major financial institution, using derivative instruments, primarily forward contracts and options to purchase and sell foreign currencies, in order to reduce the net currency exposure associated with anticipated expenses (primarily salaries and rent expenses) in currencies other than the dollar. The Group currently hedges such future exposures for a maximum period of one year. However, the Group may choose not to hedge certain foreign currency exchange exposures for a variety of reasons, including but not limited to immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange rates.

The Group records all derivatives in the consolidated balance sheet at fair value. The effective portions of cash flow hedges are recorded in other comprehensive income until the hedged item is recognized in earnings. The ineffective portions of cash flow hedges are adjusted to fair value through earnings in financial income or expense.

The Group had a net deferred gain (loss) associated with cash flow hedges of \$ (240) and \$ 1,303 recorded in other comprehensive income as of December 31, 2011 and 2012, respectively. As of December 31, 2012, the hedged transactions are expected to occur within twelve months.

The Group entered into forward and options contracts that did not meet the requirement for hedge accounting. The Group measured the fair value of the contracts in accordance with ASC 820 at level 2. The net gains recognized in "financial and other expenses, net" during the years ended December 31, 2010, 2011 and 2012 were \$ 200, \$ 187 and \$ 452, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 18:- DERIVATIVE INSTRUMENTS (Cont.)**

As of December 31, 2011 and 2012, the Group had outstanding forward and options collar (cylinder) contracts in the amount of \$ 19,100 and \$ 33,600, respectively, which were designated as salary hedging contracts.

The fair value of the Group's outstanding derivative instruments and the effect of derivative instruments in cash flow hedging relationship on other comprehensive income for the years ended December 31, 2011 and 2012, are summarized below:

Foreign exchange forward and options contracts	Balance sheet	December 31,	
		2011	2012
Fair value of foreign exchange forward and options collar (cylinder) contracts	"Other receivables and prepaid expenses"	\$ -	\$ 1,303
	"Other payables and accrued expenses"	\$ (240)	\$ -
Gains (losses) recognized in OCI (effective portion)	"Other comprehensive income"	\$ (1,062)	\$ 1,543

The effect of derivative instruments in cash flow hedging relationship on income for the years ended December 31, 2011 and 2012 is summarized below:

Foreign exchange forward and options contracts	Statements of operations	Year ended December 31,	
		2011	2012
Gain (loss) on derivatives recognized in OCI	"Operating expenses"	\$ (205)	\$ 1,211
Gain (loss) recognized in income on derivatives (effective portion)	"Operating expenses"	\$ 857	\$ (332)

**NOTE 19:- SUBSEQUENT EVENT**

In April 2013, the Company entered into an asset purchase agreement with its affiliated company MailVision. The closing of the transaction is subject to customary conditions and is expected to occur in May 2013. Pursuant to this agreement, the Company has agreed to acquire substantially all of MailVision's assets for the following consideration: (i) \$ 233 to be payable 12 months following the closing date; and (ii) additional earn out payments will be paid to MailVision subject to the achievement of certain levels of net revenues from the sale of MailVision's products during a period of no longer than three years following closing. Payment can be made, at the Company discretion, in either cash or ordinary shares. As additional for the transaction, on closing, the Company has agreed to waive repayment of any outstanding loans owed made by the Company to MailVision and to assume specified liabilities of MailVision in the aggregate amount of approximately \$ 1,300.

-----

## EXHIBIT INDEX

<b>Exhibit No.</b>	<b>Document</b>
4.17	Loan Requests, dated May 13, 2008, between First International Bank of Israel, as lender, and AudioCodes Ltd., as borrower.‡
4.18	Loan Requests, dated September 27, 2011, between First International Bank of Israel, as lender, and AudioCodes Ltd., as borrower.‡
4.19	Restated Undertaking Letter to First International Bank of Israel, dated May 6, 2008.‡
4.20	Amendments to Undertaking Letter to First International Bank of Israel, dated September 15, 2009, February 16, 2009, September 26, 2011, December 29, 2011 and July 23, 2012.‡
4.21	Letter Agreement, dated July 14, 2008, between Bank Mizrahi Tefahot Ltd., as lender, and AudioCodes Ltd., as borrower.‡
4.22	Secured Bond, dated July 14, 2008, delivered by AudioCodes Ltd., as borrower, in favor of Bank Mizrahi Tefahot Ltd., as lender.‡
4.23	Undertaking Letter to Bank Mizrahi Tefahot Ltd, dated December 12, 2011.‡
4.24	Deed of Pledge of Rights, dated December 12, 2011, delivered by AudioCodes Ltd., as borrower, in favor of Bank Mizrahi Tefahot Ltd., as lender.‡
4.25	Amendment to Undertaking Letter to Bank Mizrahi Tefahot Ltd., dated July 23, 2012.‡
4.26	Loan Requests, dated September 27, 2011, between Bank Leumi Israel Ltd., as lender, and AudioCodes Ltd., as borrower.‡
4.27	Undertaking Letter to Bank Leumi Israel Ltd., dated December 12, 2011.‡
4.28	Amendment to Undertaking Letter to Bank Leumi Israel Ltd., dated July 24, 2012.‡
12.1	Certification of Shabtai Adlersberg, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certification of Guy Avidan, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
15.1	Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.
101.1	Interactive Data Files (XBRL-Related Documents). *

‡ English translation of Hebrew original.

\* In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101 is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.



## International

Att: **The First International Bank of Israel Ltd**  
Branch - 041 - Ramat Gan

Customer name: AudioCodes Ltd

Account No.: ###-##### Branch: 041

Loan No. 000000108 Date: May 13<sup>th</sup> 2008

**Request for receipt of a loan in foreign currency**

Within the framework of the general terms for administration of the account, the general terms for receipt of loans in Israeli currency and foreign currency (hereinafter: "**the general terms**") which were signed by us and subject to their terms, we request that you provide us with a loan in foreign currency as follows:

1. **Currency of the loan** - foreign currency of type 01- US dollars
2. **Sum of loan:** 3,500,000.00
3. **Date of provision of the loan** - date of crediting the account with the sum of the loan.
4. **Date of defrayal of the loan capital** -

**Monthly payment**

In 020 equal and consecutive payments

Totalling 175,000.00 each, every 3 months on the 13<sup>th</sup> of the month starting from August 2008 and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_

---

- Monthly payments - on the last day of the month  
\_\_\_\_ equal and consecutive payments  
Totalling \_\_\_\_\_ each, every \_\_month/s on the last day of the month starting from \_\_\_\_\_ and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_.
- One payment:  
On \_\_\_\_\_.
- Various payments:  
In payments and on dates as detailed in Form 26a attached as an appendix to this request.

5. **The interest on the loan**

a. **Interest rate**

- Fixed interest - at a rate of \_\_\_\_\_% per annum (adjusted interest \_\_\_\_\_% per annum).
- Variable interest - at a rate of rounded Libor interest, as defined in the general terms, plus a margin at a rate of 0.6500% per annum (rounded Libor interest plus the margin on the date of the request is 3.4000% per annum, adjusted interest 3.5017% per annum).

b. **Dates of defrayal of interest**

- On the date(s) of defrayal of the capital of the loan as detailed above.
- Every 03 month/s on the 13<sup>th</sup> of the month starting from September 13<sup>th</sup> 2008 and final payment on the date of defrayal of the final payment on account of the capital of the loan.
- Every \_\_ month/s on the \_\_\_ of the month starting from \_\_\_\_\_ and final payment on the date of defrayal of the final payment on account of the capital of the loan.

c. **Calculation of the interest**

Notwithstanding that stated in the general rules, the interest on the loan in foreign currency in Sterling shall be calculated according to the number of days in each period of interest as compared to a year of 365 days.

d. **Accrual of interest**

- Accrual of interest in a "bullet" loan when both the capital and the interest are defrayed in one payment at the end of the term of the loan: From the date of the loan and onwards, the interest on the loan capital shall be accrued and shall be added to the loan capital on each of the following dates, and this shall also bear compound interest at a rate stated in Section 5 (a) above:

- Each \_\_\_\_ month/s on the \_\_\_\_ of the month starting from \_\_\_\_\_.
- Each \_\_\_\_ month/s on the last day of the month starting from \_\_\_\_\_.

- Accrual of interest during the period of deferral of interest payments (“grace”):

From the date of provision of the loan until the end of the “grace” period the interest on the capital of the loan shall accrue and shall be added to the capital of the loan at the end of each period of 12 months, and shall also bear compound interest as stated in Section 5(a) above.

At the end of the “grace” period the interest that accrued as aforementioned shall be deducted from the loan capital to which it was added and shall be defrayed in full on the date of defrayal (unclear) in Section 5(b) above.

Stamp: The First International Bank  
of Israel Ltd (signature)

6. **Commissions**

- a. Preparation and checking of the documents commissions totalling NIS 5300 which shall be paid on the date of provision of the loan. The sum of the loan, for the purpose of determination of the commission shall be calculated in NIS according to the representative exchange rate on the date of determination of the commission.\*

- b. Collection fees for the periodic (capital) return, totalling NIS 4.50 correct for today, that shall be paid on the date of defrayal of each payment on account of the loan capital.
- c. Additional expenses/charges collected in advance:  
Stamp duty: NIS \_\_\_\_\_, other expenses NIS \_\_\_\_\_
- d. Exchange rate list price for purchase of the currency of the loan against charge of the checking account in Israeli currency, at a rate of \_\_\_\_\_% of the minimum sum for payment \_\_\_\_\_ maximum \_\_\_\_\_ in currency \_\_\_\_\_ correct for today (subject to another arrangement, if there is such), that the payment for each period of defrayal for each payment of capital and/or interest.
- e. The list price commission for recording a transaction in a foreign currency account totals NIS 1.21, for each transaction, minimum NIS 6.05 per month correct for today (subject to another arrangement, if there is such) for registration of the loan in the account on the date of its provision for every periodic return of the loan. The commission is collected at the start of every month, for the previous month.

7. **Effective cost**

The effective cost of the loan is 3.5386% per annum.\*

8. **Instructions for charging the account**

a. **For the loan capital**

- Checking account in Israeli currency
- Checking account in the currency of the loan

b. **For the interest on the loan**

- Checking account in Israeli currency
- Checking account in the currency of the loan

c. **For the commissions**

The commissions shall be charged, in any event, to the checking account in Israeli currency. If on the date of charge of any commission whatsoever no account in our name shall be administered for a checking account in Israeli currency, within the framework of the account the number noted above, you shall be permitted to charge on the abovementioned date a checking account in the currency of the loan also for the sums of commission. The sum of the commission for the purpose of charging the foreign currency shall be calculated according to the representative exchange rate of the currency of the loan on the date of charging the commission.

9. **Interpretation**

**The terms in this request shall have the meaning given to them in the general terms, unless stated explicitly otherwise.**

\_\_\_\_\_

For internal use

\_\_\_\_\_

Audiocodes Ltd (signature)

Customer's signature

\* Commission for preparation/examination of documents and the effective cost is calculated pursuant to the sum of the loan according to the representative exchange rate known on the date of transfer of this request.

Calculation of the commission and the final effective rate shall be executed according to the representative exchange rate that shall be published on the date of trading on which the commission shall be paid.

1. To the customer 2. To the branch

**International**

**Att: The First International Bank of Israel Ltd**  
Branch - 041 - Ramat Gan

Customer name: AudioCodes Ltd

Account No.: ###-##### Branch: 041

Loan No. 000000205 Date: May 13<sup>th</sup> 2008

**Request for receipt of a loan in foreign currency.**

Within the framework of the general terms for administration of the account the general terms for receipt of loans in Israeli currency and foreign currency (hereinafter: **"the general terms"**) which were signed by us and subject to their terms, we request that you provide us with a loan in foreign currency as follows:

1. **Currency of the loan** - foreign currency of type 01- US dollars
2. **Sum of loan:** 11,500,000.00
3. **Date of provision of the loan** - date of crediting the account with the sum of the loan.



4. **Date of defrayal of the loan capital -**

**Monthly payment**

020 equal and consecutive payments

Totalling 575,000.00 each, every 3 months on the 13<sup>th</sup> of the month starting from August 2008 and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_

**Monthly payments - on the last day of the month**

\_\_\_\_\_ equal and consecutive payments

Totalling \_\_\_\_\_ each, every \_\_\_month/s on the last day of the month starting from \_\_\_\_\_ and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_.

**One payment:**

On \_\_\_\_\_.

**Various payments:**

In payments and on dates as detailed in Form 26a attached as an appendix to this request.

5. **The interest on the loan**

a. **Interest rate**

Fixed interest - at a rate of \_\_\_\_\_% per annum (adjusted interest \_\_\_\_\_% per annum).

Variable interest - at a rate of rounded Libor interest, as defined in the general terms, plus a margin at a rate of 1.5000% per annum (rounded Libor interest plus the margin on the date of the request is 4.2500% per annum, adjusted interest 4.3924% per annum).

b. **Dates of defrayal of interest**

- On the date(s) of defrayal of the capital of the loan as detailed above.
- Every 03 month/s on the 13<sup>th</sup> of the month starting from August 13<sup>th</sup> 2008 and final payment on the date of defrayal of the final payment on account of the capital of the loan.
- Every \_\_ month/s on the \_\_\_ of the month starting from \_\_\_\_\_ and final payment on the date of defrayal of the final payment on account of the capital of the loan.

c. **Calculation of the interest**

Notwithstanding that stated in the general rules, the interest on the loan in foreign currency in Sterling shall be calculated according to the number of days in each period of interest as compared to a year of 365 days.

d. **Accrual of interest**

- Accrual of interest in a “bullet” loan when both the capital and the interest are defrayed in one payment at the end of the term of the loan:

From the date of the loan and onwards, the interest on the loan capital shall be accrued and shall be added to the loan capital on each of the following dates, and this shall also bear compound interest at a rate stated in Section 5 (a) above:

Each \_\_\_\_ month/s on the \_\_\_\_ of the month starting from \_\_\_\_\_.

Each \_\_\_\_ month/s on the last day of the month starting from \_\_\_\_\_.

Accrual of interest during the period of deferral of interest payments (“grace”):

From the date of provision of the loan until the end of the “grace” period the interest on the capital of the loan shall accrue and shall be added to the capital of the loan at the end of each period of 12 months, and shall also bear compound interest as stated in Section 5(a) above.

At the end of the “grace” period the interest that accrued as aforementioned shall be deducted from the loan capital to which it was added and shall be defrayed in full on the date of defrayal (unclear) in Section 5(b) above.

Stamp: The First International Bank  
of Israel Ltd (signature)

6. **Commissions**

- a. Preparation and checking of the documents commissions totalling NIS 5300 which shall be paid on the date of provision of the loan. The sum of the loan, for the purpose of determination of the commission shall be calculated in NIS according to the representative exchange rate on the date of determination of the commission.\*
- b. Collection fees for the periodic (capital) return, totalling NIS 4.60 correct for today, that shall be paid on the date of defrayal of each payment on account of the loan capital.
- c. Additional expenses/charges collected in advance:  
Stamp duty: NIS \_\_\_\_\_, other expenses NIS \_\_\_\_\_
- d. Exchange rate list price for purchase of the currency of the loan against charge of the checking account in Israeli currency, at a rate of \_\_\_\_\_% of the minimum sum for payment \_\_\_\_\_ maximum \_\_\_\_\_ in currency \_\_\_\_\_ correct for today (subject to another arrangement, if there is such), that the payment for each period of defrayal for each payment of capital and/or interest.
- e. The list price commission for recording a transaction in a foreign currency account totalling NIS 1.21, for each transaction, minimum NIS 6.05 per month correct for today (subject to another arrangement, if there is such) for registration of the loan in the account on the date of its provision for every periodic return of the loan. The commission is collected at the start of every month, for the previous month.

7. **Effective cost**

The effective cost of the loan is 4.4028% per annum.\*

8. **Instructions for charging the account**

a. **For the loan capital**

- Checking account in Israeli currency
- Checking account in the currency of the loan

b. **For the interest on the loan**

- Checking account in Israeli currency
- Checking account in the currency of the loan

c. **For the commissions**

The commissions shall be charged, in any event, to the checking account in Israeli currency. If on the date of charge of any commission whatsoever no account in our name shall be administered for a checking account in Israeli currency, within the framework of the account the number of which is noted above, you shall be permitted to charge on the abovementioned date a checking account in the currency of the loan also for the sums of commission. The sum of the commission for the purpose of charging the foreign currency shall be calculated according to the representative exchange rate of the currency of the loan on the date of charging the commission.

9. **Interpretation**

**The terms in this request shall have the meaning given to them in the general terms, unless stated explicitly otherwise.**

\_\_\_\_\_  
For internal use

\_\_\_\_\_  
Audiocodes Ltd (signature)  
Customer's signature

\* Commission for preparation/examination of documents and the effective cost is calculated pursuant to the sum of the loan according to the representative exchange rate known on the date of transfer of this request.

Calculation of the commission and the final effective rate shall be executed according to the representative exchange rate that shall be published on the date of trading on which the commission shall be paid.

1. To the customer 2. To the branch

**International**

**Att: The First International Bank of Israel Ltd**  
Branch: Ramat Gan

Customer name: AudioCodes Ltd  
Clerk's Name: Sigalit  
Date of printout: May 13<sup>th</sup> 2008

**Customer's instruction for deposit of a foreign currency deposit - non-renewable**

Within the framework of the general rules for administration of an account that we signed (hereinafter: "**the general terms**") we request to charge on the date of deposit into our checking account in the currency of the deposit the sum of the deposit, and in return to deposit in our favour a deposit of the aforementioned type for a term and on conditions as detailed hereinafter:

Currency of the deposit	Date of the deposit	Date of defrayal	Account No.	Type of Account	Branch
US\$	May 13 <sup>th</sup> 2008	August 13 <sup>th</sup> 2008	#####	506	041
Sum of the deposit in foreign currency (capital of the deposit) 3.5M		Annual interest % <u>2.1%</u>	Adjusted annual interest ____%		

**1. Deposit of the deposit**

- 1.1. We are aware that the bank shall be permitted, at its discretion, not to execute this request, in the absence of a sufficient balance to execute it and/or if there shall be in the opinion of the bank a legal preclusion or any other preclusion for its execution.

1.2. A request that shall be received at the bank after a time that shall be determined by the bank, from time to time, at the end of the working day or at another time for receipt of a request of this type of request for execution on that same foreign currency business day, the earliest between them, or a request that shall be received at the bank on a day which is not a foreign currency business day, shall be executed on the first working day in foreign currency after the date of the request, and this day shall be considered to be the date of the deposit.

In this document “**a foreign currency business day**” - a business day in the bank, in which the bank executes transactions in the currency of the deposit, without limitation to the sums of the transactions and on which bank publishes transfers and cheques rates.

2. **The term of the deposit**

The deposit shall be deposited for a period from the date of the deposit and until the date of the defrayal (not including this day).

3. **Interest on the deposit**

The capital on the deposit shall bear fixed interest at a rate noted above, for the full term of the deposit in which the deposit was deposited in the deposit account.

The interest on the deposit shall be calculated according to the number of days in the period of calculation of the interest as compared to a year of 365 days.



In the event that a deposit has been deposited for a period exceeding one year, the interest shall be calculated by annual compound interest.

4. **Date of defrayal of the capital of the deposit and the interest**

The capital of the interest and the deposit shall be defrayed to us in one payment, on the date of defrayal noted above, in favour of our checking account in the currency of the deposit.

5. **Prohibition of withdrawal prior to the date of defrayal**

5.1. We shall not be permitted to withdraw the deposit or part of it other than on the date noted above, unless with the consent of the bank in advance and in writing.

The bank shall be permitted to condition its consent on conditions that shall be determined by it including payment of the excess cost to the bank, if there shall be such, as a result of withdrawal of the discount other than on the date of defrayal as aforementioned, and all taking into consideration the damage that could be caused to the bank as a result of the aforementioned withdrawal.

5.2. Without derogating from the generality of the aforementioned, we are aware that in the event that the bank shall consent to withdrawal of the deposit or part of it prior to the date of defrayal as aforementioned then, notwithstanding the aforementioned in this document above, we shall not be entitled, *inter alia*, to interest on the sum withdrawn, for the period that passed from the date of the deposit and until the date of its withdrawal.

6. **Deferral of dates of defrayal**

In the event that the date of defrayal shall fall on a day that is not a foreign currency business day (as defined in Section 1 above) the date of defrayal shall be deferred to the first working day in foreign currency following it, and the interest shall be calculated pursuant to the actual date of defrayal.

7. **Prohibition of transfer of rights**

Our rights in regard to the deposit, in entirety or in part, shall not be transferred without the consent of the bank in advance and in writing.

8. **Tax deduction**

If the duty by law, including foreign law, of withholding of any tax at source levy or other mandatory payment is imposed on the bank, then the sum of the deposit and the interest on it shall be available to us on the date of defrayal only after deduction of tax as aforementioned.

Without derogating from the generality of the aforementioned, the bank shall be permitted to charge our account for any sum that the bank shall be required to transfer to an authorized authority for monies as aforementioned which were paid to us without withholding of any tax at source.

9. **Commission**

The list price of the commission for recording a transaction in a foreign currency account (for deposit transactions and deposit defrayal) shall be NIS 1.21 for each transaction minimum NIS 6.95 per month, as of today (subject to another arrangement if there is such) and it shall be collected at the start of the month following the execution of the transaction.

10. **Interpretations**

In the event of a contradiction between the provisions of this document and the general terms, the provisions of this document shall have priority.

Audiocodes Ltd  
(signature)  
Customer's signature

**International****Att: The First International Bank of Israel Ltd**Branch - 041 - Ramat GanCustomer name: AudioCodes LtdAccount No.: ###-#####Date: 27/09/2011Loan No. 000000493**Request for receipt of a loan in foreign currency.**

Within the framework of the general terms for administration of the account, the general terms for receipt of loans in Israeli currency and foreign currency (hereinafter: the "**General Terms**") which were signed by us and subject to their terms, we request that you provide us with a loan in foreign currency as follows:

1. **Currency of the loan** - foreign currency of type 01- US dollars
2. **Sum of loan:** 3,375,000.00
3. **Date of provision of the loan** - date of crediting the account with the sum of the loan.
4. **Date of defrayal of the loan capital** -

 **Monthly payment**In 020 equal and consecutive paymentsTotalling 160,700.00 each, every 3 months on the 27<sup>th</sup> of the month starting from September 2012 and the final payment totalling 161,000.00 on 27/09/2017.

Monthly payments - on the last day of the month

In \_\_\_\_ equal and consecutive payments

Totalling \_\_\_\_\_ each, every \_\_month/s on the last day of the month starting from \_\_\_\_\_ and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_.

One payment:

On \_\_\_\_\_.

Various payments:

In payments and on dates as detailed in Form 26a attached as an appendix to this request.

5. **The interest on the loan**

a. **Interest rate**

Fixed interest - at a rate of \_\_\_\_% per annum.

Variable interest - at a rate of rounded Libor interest, as defined in the general terms, plus a margin at a rate of 3.1000% per annum (rounded Libor interest plus the margin on the date of the request is 3.4750% per annum).

b. **Dates of defrayal of interest**

- On the date(s) of defrayal of the capital of the loan as detailed above.
- Every 03 month/s on the 27<sup>th</sup> of the month starting from 27/12/2011 and final payment on the date of defrayal of the final payment on account of the capital of the loan.
- Every \_\_ month/s on the \_\_ of the month starting from \_\_\_\_\_ and final payment on the date of defrayal of the final payment on account of the capital of the loan.

c. **Calculation of the interest**

The interest shall be calculated in accordance with the General Terms, provided that the interest on a loan in foreign currency in Lira Sterling shall be calculated according to the number of days in each period of interest as compared to a year of 365 days.

d. **Accrual of interest**

- Accrual of interest in a “bullet” loan when both the capital and the interest are defrayed in one payment at the end of the term of the loan:

From the date of the loan and onwards, the interest on the loan capital shall be accrued and shall be added to the loan capital on each of the following dates, and this shall also bear compound interest at a rate stated in Section 5 (a) above:

- Each \_\_\_\_ month/s on the \_\_\_\_ of the month starting from \_\_\_\_\_.
- Each \_\_\_\_ month/s on the last day of the month starting from \_\_\_\_\_.
- Accrual of interest during the period of deferral of interest payments (“Grace”):

From the date of provision of the loan until the end of the “Grace” period the interest on the capital of the loan shall accrue and shall be added to the capital of the loan at the end of each period of 12 months, and shall also bear compound interest as stated in Section 5(a) above.

At the end of the “Grace” period the interest that accrued as aforementioned shall be deducted from the loan capital to which it was added and shall be defrayed in full on the date of defrayal (unclear) in Section 5(b) above.

Stamp: Audiocodes Ltd. /S/

6. **Commissions**

- a. Preparation and checking of the documents commissions totalling NIS 3,312.50 which shall be paid on the date of provision of the loan. The Shekel value of the loan sum, for the purpose of determination of the commission shall be calculated according to the known exchange rate on the date of this request.

- b. Collection fees for the periodic return, totalling NIS 5.20 correct for today, that shall be paid on the date of defrayal of each payment on account of the loan capital.
- c. Tariff commission (subject to another arrangement, if such exist), for the recording of an activity in the account, for the recording of a loan on the grant date and for any periodic refund of the loan.  
As of today, the commission rate is-  
In a foreign exchange checking account – 1.45NIS for any activity, minimum 7.25NIS per month.  
In an Israeli checking account- 1.50NIS for any activity.  
The commission is collected at the beginning of every month for the preceding month.
- d. Exchange rate tariff commission (subject to another arrangement, if such exist) for purchase of the currency of the loan against charge of the checking account in Israeli currency, at a rate of \_\_\_\_\_% of the minimum sum for payment \_\_\_\_\_ maximum \_\_\_\_\_ in currency \_\_\_\_\_ correct for today, which shall be paid every repayment date for each payment of capital and/or interest.
- e. Other expenses/ charges collected in advance \_\_\_\_\_ NIS.

7. **Effective cost**

The effective cost of the loan, when it is calculated by the relevant data on the request date is 3.5786% per annum.



8. **Instructions for charging the account**

a. **For the loan capital**

- Checking account in Israeli currency
- Checking account in the currency of the loan

b. **For the interest on the loan**

- Checking account in Israeli currency
- Checking account in the currency of the loan

c. **For the commissions**

The commissions shall be charged to the checking account in Israeli currency, unless we were instructed otherwise. If on the date of charge of any commission whatsoever no account in our name shall be administered for a checking account in Israeli currency, or in another currency (which is not the loan currency) which we requested you to charge the abovementioned commissions, within the framework of the account the number noted above, you shall be permitted to charge on the abovementioned date a checking account in the currency of the loan also for the sums of commission. The sum of the commission for the purpose of charging the foreign currency shall be calculated according to the representative exchange rate of the currency of the loan on the date of charging the commission.

9. **Non Payment on Time**

Without derogating from your right to immediate repayment of the loan according to the brought forth in the General Terms, any sum of the loan payment that shall not be paid by us on the repayment date, shall bear interest as brought forth in the General Terms, which shall also accrue and bear compounded interest as mentioned above, in the frequency and dates according to the dates of payment/ interest accrual or at the end of each calendar quarter or upon any other period, all according to the bank's choosing and subject to the law.

10. **Early repayment**

Early repayment of the loan, entirely or partially, prior to the dates prescribed for its repayment, shall be charged an early repayment charge and any other charge, as shall be determined in the bank at the time of the early repayment.

If the Bank is permitted, according to the provisions of any law, to charge an early repayment commission and/ or any other payment of varying rates, the Bank shall charge the greatest of them. Furthermore, the Bank shall be permitted to stipulate the early repayment by the payment of minimal payment rates partially of the loan and/ or by giving a prior notice and/ or any other condition.

11. **Interpretation**

**The terms in this request shall have the meaning given to them in the general terms, unless stated explicitly otherwise.**

/S/Audiocodes Ltd

116459

Customer's signature

For internal use

**International**

**Att: The First International Bank of Israel Ltd**

Branch - 041 - Ramat Gan

Customer name: AudioCodes Ltd

Account No.: ###-#####

Date: 27/09/2011

Loan No. 000000302

**Request for receipt of a loan in foreign currency**

Within the framework of the general terms for administration of the account, the general terms for receipt of loans in Israeli currency and foreign currency (hereinafter: the "**General Terms**") which were signed by us and subject to their terms, we request that you provide us with a loan in foreign currency as follows:

1. **Currency of the loan** - foreign currency of type 01- US dollars
2. **Sum of loan:** 3,375,000.00
3. **Date of provision of the loan** - date of crediting the account with the sum of the loan.
4. **Date of defrayal of the loan capital** -

**Monthly payment**

In 020 equal and consecutive payments

Totalling 160,700.00 each, every 3 months on the 27<sup>th</sup> of the month starting from September 2012 and the final payment totalling 161,000.00 on 27/09/2017.

Monthly payments - on the last day of the month

In \_\_\_\_ equal and consecutive payments

Totalling \_\_\_\_\_ each, every \_\_month/s on the last day of the month starting from \_\_\_\_\_ and the final payment totalling \_\_\_\_\_ on \_\_\_\_\_.

One payment:

On \_\_\_\_\_.

Various payments:

In payments and on dates as detailed in Form 26a attached as an appendix to this request.

5. **The interest on the loan**

a. **Interest rate**

Fixed interest - at a rate of \_\_\_\_% per annum.

Variable interest - at a rate of rounded Libor interest, as defined in the general terms, plus a margin at a rate of 2.1000% per annum (rounded Libor interest plus the margin on the date of the request is 2.4750% per annum).

b. **Dates of defrayal of interest**

- On the date(s) of defrayal of the capital of the loan as detailed above.
- Every 03 month/s on the 27<sup>th</sup> of the month starting from 27/12/2011 and final payment on the date of defrayal of the final payment on account of the capital of the loan.
- Every \_\_ month/s on the \_\_\_ of the month starting from \_\_\_\_\_ and final payment on the date of defrayal of the final payment on account of the capital of the loan.

c. **Calculation of the interest**

The interest shall be calculated in accordance with the General Terms, provided that the interest on a loan in foreign currency in Lira Sterling shall be calculated according to the number of days in each period of interest as compared to a year of 365 days.

d. **Accrual of interest**

- Accrual of interest in a “bullet” loan when both the capital and the interest are defrayed in one payment at the end of the term of the loan:

From the date of the loan and onwards, the interest on the loan capital shall be accrued and shall be added to the loan capital on each of the following dates, and this shall also bear compound interest at a rate stated in Section 5 (a) above:

- Each \_\_\_\_ month/s on the \_\_\_\_ of the month starting from \_\_\_\_\_.
- Each \_\_\_\_ month/s on the last day of the month starting from \_\_\_\_\_.
- Accrual of interest during the period of deferral of interest payments (“Grace”):

From the date of provision of the loan until the end of the “Grace” period the interest on the capital of the loan shall accrue and shall be added to the capital of the loan at the end of each period of 12 months, and shall also bear compound interest as stated in Section 5(a) above.

At the end of the “Grace” period the interest that accrued as aforementioned shall be deducted from the loan capital to which it was added and shall be defrayed in full on the date of defrayal (unclear) in Section 5(b) above.

Stamp: Audiocodes Ltd. /S/

6. **Commissions**

- a. Preparation and checking of the documents commissions totalling NIS 3,312.50 which shall be paid on the date of provision of the loan. The Shekel value of the loan sum, for the purpose of determination of the commission shall be calculated according to the known exchange rate on the date of this request.

- b. Collection fees for the periodic return, totalling NIS 5.20 correct for today, that shall be paid on the date of defrayal of each payment on account of the loan capital.
- c. Tariff commission (subject to another arrangement, if such exist), for the recording of an activity in the account, for the recording of a loan on the grant date and for any periodic refund of the loan.  
As of today, the commission rate is-  
In a foreign exchange checking account – 1.45NIS for any activity, minimum 7.25NIS per month.  
In an Israeli checking account- 1.50NIS for any activity.  
The commission is collected at the beginning of every month for the preceding month.
- d. Exchange rate tariff commission (subject to another arrangement, if such exist) for purchase of the currency of the loan against charge of the checking account in Israeli currency, at a rate of \_\_\_\_\_% of the minimum sum for payment \_\_\_\_\_ maximum \_\_\_\_\_ in currency \_\_\_\_\_ correct for today, which shall be paid every repayment date for each payment of capital and/or interest.
- e. Other expenses/ charges collected in advance \_\_\_\_\_ NIS.

7. **Effective cost**

The effective cost of the loan, when it is calculated by the relevant data on the request date is 2.5414% per annum.



8. **Instructions for charging the account**

a. **For the loan capital**

- Checking account in Israeli currency
- Checking account in the currency of the loan

b. **For the interest on the loan**

- Checking account in Israeli currency
- Checking account in the currency of the loan

c. **For the commissions**

The commissions shall be charged to the checking account in Israeli currency, unless we were instructed otherwise. If on the date of charge of any commission whatsoever no account in our name shall be administered for a checking account in Israeli currency, or in another currency (which is not the loan currency) which we requested you to charge the abovementioned commissions, within the framework of the account the number noted above, you shall be permitted to charge on the abovementioned date a checking account in the currency of the loan also for the sums of commission. The sum of the commission for the purpose of charging the foreign currency shall be calculated according to the representative exchange rate of the currency of the loan on the date of charging the commission.

9. **Non Payment on Time**

Without derogating from your right to immediate repayment of the loan according to the brought forth in the General Terms, any sum of the loan payment that shall not be paid by us on the repayment date, shall bear interest as brought forth in the General Terms, which shall also accrue and bear compounded interest as mentioned above, in the frequency and dates according to the dates of payment/ interest accrual or at the end of each calendar quarter or upon any other period, all according to the bank's choosing and subject to the law.

10. **Early repayment**

Early repayment of the loan, entirely or partially, prior to the dates prescribed for its repayment, shall be charged an early repayment charge and any other charge, as shall be determined in the bank at the time of the early repayment.

If the Bank is permitted, according to the provisions of any law, to charge an early repayment commission and/ or any other payment of varying rates, the Bank shall charge the greatest of them. Furthermore, the Bank shall be permitted to stipulate the early repayment by the payment of minimal payment rates partially of the loan and/ or by giving a prior notice and/ or any other condition.

11. **Interpretation**

**The terms in this request shall have the meaning given to them in the general terms, unless stated explicitly otherwise.**

/S/Audiocodes Ltd

116459

Customer's signature

For internal use

Date: May 6<sup>th</sup> 2008

Att:

The First International Bank of Israel Ltd (hereinafter: **“the bank”**)  
Ramat Gan Branch

Dear Sir or Madam,

Whereas Audiocodes Ltd (hereinafter: “the company”) benefits from credit and various banking services (hereinafter: “the credit”);

And whereas the company has approached you with a request to increase its credit, that is, to grant a credit line for long term loans and you approved the aforementioned credit line, for a sum that shall not exceed 15,000,000 dollars on the terms detailed in the credit line approval attached as Appendix A (hereinafter: “the loans”);

And whereas Shabtai Adlersberg holds shares in the company and is a stakeholder in the company as detailed in his report to the Securities Authority in the United States in February 2008 attached as an integral part of this document and according to the definition of the term “stakeholder” in the Securities Law 5728-1968 (hereinafter: “the stakeholder”);

And whereas as one of the terms for provision of the loans the bank has demanded that the company and the stakeholder shall sign on this document and the undertakings detailed hereinafter, and the company and the stakeholder have consented to this.

---

Now therefore the company declares and undertakes vis-à-vis the bank that for as long as there shall be debts and undertakings of the company vis-à-vis the bank for provision of the loans, all the following shall be imposed:

1. The company shall comply at all times with the terms and the financial ratios hereinafter, which shall be examined pursuant to the company's consolidated quarterly financial reports (the annual reports shall be audited pursuant to US GAAP or other regulatory rules which shall come in their stead).
  - 1.1. The company's equity capital according to the financial reports as shall be detailed hereinafter shall be no less than a total of 25,000,000 dollars and the percentage relative to the total of the balance sheet shall not be less than 15%. Starting from the balance sheet of December 31<sup>st</sup> 2009 the company's capital equity, as detailed hereinafter, shall be no less than a total of 30,000,000 dollars and its percentage relative to the balance sheet shall not be less than 15%.

The equity capital - as it appears in the company's financial reports (including *inter alia* the company's redeemed equity capital, capital funds, the balance of the profit which were undesignated less the cost of the company shares held by it or by subsidiaries plus/less any other clause included within the framework of the equity capital clause in the financial reports) plus the deferred owners loans, less the loans provided to affiliated parties, less intangible assets as they shall appear in the company's financial reports.

[In this matter, affiliated parties, are according to their meaning in Manifesto No. 29 as regards affiliated parties of the Institute of Certified Public Accountants in Israel.]

Sums that shall be deducted from the equity capital for the purpose of calculation the equity capital as defined above, shall be deducted also from the total of the balance sheet for the purpose of calculating its percentage, as required in the preface to Section 1.1 above.

- 1.2. The total of the company's bank financing undertakings shall not exceed \$30,000,000. It is hereby clarified that the company's 2% Senior Convertible Notes Due 2024 ("Convertible Notes") shall not be taken into account as financing undertakings. The loan shall not be a senior convertible note of the company.

The bank financing undertakings are defined as loans (short term and long term) from banks and other financial institutions.

- 1.3. The accrued operating capital (US GAAP) for the last 4 quarters starting from December 31<sup>st</sup> 2008 shall not be less than a total of \$3,000,000. Notwithstanding the aforementioned, a loss of up to \$3,000,000 for an accounting record for the value of the benefit grossed up by granting options to employees pursuant to FAS123 shall not constitute a breach of the criteria.
- 1.4. Up to the date of realization of the options for redemption of the convertible notes (Security No. 050732AB2) (hereinafter: "the bond") in November 2009, the inclusive sum received in cash (as defined hereinafter) plus investments (as defined hereinafter) shall not be less at any time than 120,000,000 dollars. The balance of the cash shall not be less at any time than 15,000,000 dollars.

From the date of redemption of the bond the inclusive bond received from the company's chargeable customers plus cash and plus investments shall not be less at any time than a total of 40,000,000 dollars whereby the inclusive sum received from cash plus investments shall not be less at any time than a sum of 20,000,000 dollars and the cash balance shall not be less at any time than 15,000,000 dollars.

Cash - as it appears in the company's financial reports includes cash and cash equivalent, short term deposits for a term of up to one year.

Investment - long term deposits up to two years, negotiable bonds ranked A+ for a term of up to two years.

- 1.5. Notwithstanding the aforementioned in Section 1.2 above, in the event that the total bank financing of the company shall not exceed 15,000,000 dollars, the inclusive sum received from cash plus investments shall not be less at any time than a sum of 10,000,000 dollars, and including the company's receivable customers no less than 20,000,000 dollars.

The company declares that as of the date of signature on this document it is complying with the terms and the financial ratios determined in Section 1 above.

2. The company undertakes that inasmuch as the regulatory rules that shall be implemented differ from those implemented by it on the date of signature on this letter of undertaking, the company shall approach the bank in order to correlate its undertakings pursuant to Section 1 above to the changes derived from the implementation of the rules. In the event that the company and the bank shall not reach an agreement in regard to the changes required within 30 days from the date that the company contacted the bank or within another time period to be determined by the parties, this shall be cause for immediate defrayal of the company's debts and undertakings.
3. There shall be no change to the holdings of the stakeholder in the company as such that he shall decrease his holdings under the percentage of holdings required pursuant to the Securities Law 5728-1968 for the purpose of defining a stakeholder, without the consent of the bank in advance and in writing.
4. Loans that the company has received and/or shall receive from the stakeholder in the company (hereinafter: "owners loans") shall be inferior and deferred from the company's debts and obligations to the bank for provision of the loans, and that the company's debts and undertakings vis-à-vis the bank for provision of the loans shall have priority as compared to the owners loans as they shall be at any time. To avoid doubt, it is hereby clarified that the services that the stakeholder provides and/or shall provide to the company "as a functionary" of the company, including as Chairman of the Board of Directors, President and/or CEO of the company, shall not be considered as owners loans, and the company's debts and undertakings vis-à-vis the bank shall not have priority as compared to these services, and the company shall be permitted to pay the stakeholder for these services without any restriction.



5. The company undertakes not to pay management fees, dividends, interest payments and/or any other payment to shareholders, and not to defray owners loans or any part of them until all the sums due from it have been defrayed in full to the bank for provision of the loans, and for as long as all the company's debts and undertakings shall not be defrayed in full to the bank for provision of the loans. To avoid doubt it is hereby clarified that the company is not restricted (a) in purchase of company shares and/or convertible bonds of the company on condition that the company complies with the terms and financial ratios determined in Section 1 above; (b) in payment of interest and/or other payments imposed and/or shall be imposed on the convertible note.
6. We hereby declare that as of the date of signature on this document (apart from that detailed in the Registrar of Companies report) we have not created any pledge and any lien of any type whatsoever on any asset whatsoever of our assets and we have not provided any guarantee whatsoever in favour of any third party whatsoever, and also we have not undertaken to create a pledge and/or lien and/or to provide a guarantee as aforementioned, and all apart from the guarantees during the normal course of business and bank guarantees (which were not provided against them, by us, guarantees that are not during the normal course of business and/or other securities whatsoever).

Notwithstanding the aforementioned in this section, the company shall be permitted to create a floating lien in favour of other banks, and a first degree fixed lien on monetary deposits that shall be deposited from time to time in those same banks on condition that prior to the creation of the liens, a *pari passu* agreement shall be signed between the banks in regard to the division of the considerations from realization of the liens.

To avoid doubt it shall be clarified that in the event that the company shall create any other security to guarantee its debts vis-à-vis another bank whereby between it and the bank a *pari passu* agreement shall be signed as aforementioned, the company shall also create that same security in favour of the bank.

7. We hereby undertake that we shall not sell and/or transfer and/or hand over and/or lease and/or rent (hereinafter, jointly and severally - transfer) any assets whatsoever (including monies), of any shape or form whatsoever, as they are extant at present and as they shall be in the future in entirety or in part, from our ownership and/or our possession for a continuous period of 12 months, whereby the value of the assets exceeds 1 million US dollars (or equivalent value in foreign currency and/or in NIS), not during the normal conduct of business and for full remuneration to third parties (including any of them who are our shareholders directly or indirectly), without the consent of the bank in writing and in advance.
8. We hereby undertake that we shall not execute purchases/investments of any type whatsoever of/in companies and/or of/in assets and in any way whatsoever, whether indirectly or directly, whereby the sum of the purchase/investment exceeds 10 million US dollars (or the equivalent value in foreign currency and/or in NIS, pursuant to the cost of the investment) for a continuous period of 12 months, without notice to the bank in writing and in advance. Notice to the bank shall not be given before a notice to the public if such shall be required.

9. The company shall present to the bank close to receipt of its request, ongoing documents and information as regards the company businesses and its financial status without derogating from the generality of the aforementioned, the bank shall receive, *inter alia*, starting from the date of signature on this document ongoing reports as follows:
- 9.1. Within 180 days from December 31<sup>st</sup> of each year the company shall transfer to the bank all its financial reports for December 31<sup>st</sup> of the year that has ended, whereby the abovementioned reports are audited by an external CPA.
  - 9.2. Within 75 days from the last day of each of the months March, June, September and December of every year the company shall transfer to the bank all the company notices to the press as regards a summary of the financial reports relating to the calendar quarter ending on the last day of each of the abovementioned months including a report on changes to equity capital which were made pursuant to accepted accounting principles (US GAAP).
  - 9.3. Within 30 days from the last day of each quarter the company shall transfer to the bank receivables data (including customers in Israel, overseas, various receivables and debts to creditors with priority) and debit balances to the banking system. The data shall relate to the last day of each quarter.

- 9.4. Within 30 days from the last day of each quarter the company shall transfer to the bank a report of the composition of the company's investments portfolio including the ranking of the securities composing the company's investments portfolio. The report shall be signed by the company and include reference by the company as to their compliance with the criteria as detailed in Section 1.4 above.
- 9.5. In the event that the company shall prepare additional financial reports in Israel and overseas, audited or unaudited and/or additional financial reports such as prospectuses, business plans and so forth, presented to any entities whatsoever in Israel or overseas and published by the company, the company shall transfer copies of these reports to the bank immediately on their preparation.
- 9.6. Without derogating from the aforementioned in this section, the bank representatives shall be permitted to meet with the company's CPA at any time at their request for the purpose of ascertaining the data regarding the financial status of the company.

For the purpose of this document the term "financial reports" shall be interpreted as - balance sheet, profit and loss report, cash flow report, changes to equity capital report including annotations to them which were prepared and audited pursuant to accepted accounting rules (US GAAP).

10. The company shall inform the bank immediately of any claim or legal proceeding exceeding a sum of one million dollars of any type whatsoever which have been filed or have been opened with a court, tribunal or any other judicial institution, in Israel or overseas.
11. The company is aware that in any event of breach of one or more of its undertakings pursuant to this document including in the event of a breach derived from implementation of regulatory rules that are different to those implemented by it on the date of signature on this letter of understanding, in entirety or in full, then further to any other relief that the bank shall be entitled to pursuant to any document that has been signed and/or shall be signed by the company and subject to the company's right to remedy these breaches if and inasmuch that it exists and/or subject to any law, the bank shall be permitted, but not obligated, to defray immediately the sums due to it from the company for provision of the loans, in entirety or part of them, and to realize any security and/or guarantee provided to it by the company and/or for it.
12. All the company's and the stakeholder's undertakings pursuant to this document and all the bank's rights pursuant to it are in addition to and independent of the undertakings, the securities and the guarantees that the bank received and/or shall receive from the company and/or from the stakeholder and/or from either of them and they shall not influence them and shall not be influenced by them.
13. The bank's waiver of any prior breach whatsoever or any prior non-compliance whatsoever of one or more of the undertakings to them, whether that same undertaking is incorporated in this document or whether it is incorporated or shall be incorporated in any other document whatsoever, shall not be considered as justification for an additional breach or an additional non-compliance of any condition or undertaking as aforementioned; and the bank's abstention from use of any right whatsoever given to it pursuant to any document whatsoever and/or pursuant to any law, shall not be interpreted as a waiver of that same right.

14. To avoid doubt it is hereby clarified that nothing stated in this document shall derogate or diminish in any way whatsoever from any undertaking by the company and/or the stakeholder and/or either of them vis-à-vis the bank and/or any right or obligation whatsoever of the bank vis-à-vis the company and/or vis-à-vis the stakeholder pursuant to a general current loan account contract and any other document which has been signed and/or shall be signed by them and/or by any of them.

Yours sincerely,

(signature)

(signature)

---

Stamp: Audiocodes Ltd

Public Co. 520044132

I the undersigned, a shareholder/stakeholder and company CEO of Audiocodes Ltd (hereinafter: “the company”) confirm and undertake to you as follows:

1. I confirm my consent to provide the aforementioned undertakings by the company.
2. I undertake not to cause or to agree to a change in the percentage of my holdings in the company, which shall decrease my holdings to less than the percentage of holdings required pursuant to the Securities Law, 5728-1968 as regards the definition of a stakeholder, including by way of transfer of shares and/or allocation of shares and/or in any other fashion and to change the identity of the stakeholder as such that it shall cause the company to breach its abovementioned undertakings.
3. I agree and undertake that the loans that the company has received and/or shall receive from me (hereinafter: “the owners loans”) shall be inferior and deferred from the company’s debts and undertakings to the bank for provision of the loans and that the company’s debts and undertakings vis-à-vis the bank for provision of the loans shall have priority as compared to the company’s debts to me for the owners loans as they shall be from time to time, and that the company and/or its representative and/or on its behalf shall pay and defray to the bank all its debts and undertakings to the bank, and this before defrayal of the owners loans as they shall be at that time. To avoid doubt it is hereby clarified that the services that the stakeholder provides and/or shall provide to the company as a “functionary” of the company, including as chairman of the board of directors, president and/or company CEO, shall not be considered as owners loans, and the company’s debts and obligations vis-à-vis the bank shall not have priority as compared to these services and the company shall be permitted to pay the stakeholder for these services without any restriction.

4. Without derogating from the aforementioned in Section 3 above I hereby undertake not to request and not to receive from the company by any method whatsoever payments on account of the defrayal of the owners loans, or any part of them, for as long as the company's debts and undertakings have not been defrayed in full to the bank for the provision of the loans. To avoid doubt, it is hereby clarified that the company shall be permitted to pay the stakeholder for services that the stakeholder provides and/or shall provide to the company as a "functionary" of the company, including as chairman of the board of directors, president and/or company CEO without any restriction.
5. I hereby undertake that in the event that for any reason whatsoever I shall receive any payment whatsoever on account of defrayal of the owners loans, and this when at that time you have not received defrayal of the company's debts and undertakings in full to you for the provision of the loans, I shall pay and defray to you any sum that shall be paid to me and/or that I shall receive on account of defrayal of the owners loans as aforementioned.
6. My aforementioned undertakings shall be rescinded on the cancellation of the company's aforementioned undertaking without any further notice.

Date: May 6<sup>th</sup> 2008

Name: Shabtai Adlersberg

Signature: (Signature) \_\_\_\_\_



**Confirmation of the Chairman of the Board of Directors**

I the undersigned Shabtai Adlersberg, Chairman of the Board of Directors of AudioCodes Ltd (hereinafter "the company") hereby confirm the following:

1. The company has resolved to undertake vis-à-vis the First International Bank in Israel Ltd (hereinafter: "the bank") to guarantee defrayal of the loans; the undertakings detailed in the document attached to this confirmation are an integral part of it thereof.
2. The company Board of Directors confirm that all the approvals required by law and pursuant to the incorporation documents of the company have been received for the undertakings detailed in Section 1 above.
3. Mr Shabtai Adlersberg, ID. ##### whose position is Chairman and CEO and Mr Nachum Falek, ID. ##### whose position is VP Finance have been authorized to sign on any documents required and that shall be required by the bank in regard to execution of the abovementioned resolutions.

(signature)  
\_\_\_\_\_  
Signature of Chairman

May 6<sup>th</sup> 2008  
\_\_\_\_\_  
Date

**Confirmation of Attorney**

I the undersigned Itamar Rosen, the company attorney, hereby confirm as follows:

1. This document has been signed by the Chairman of the Board of Directors, Mr Shabtai Adlersberg, who is known to me personally.
2. The resolutions detailed above were passed lawfully, pursuant to the documents of incorporation of the company.
3. All the approvals required by law have been received, including pursuant to the provisions imposed on "Transactions with Stakeholders", if and inasmuch as they are imposed, for ratification of the transactions detailed in Section 1 above.
4. The signatures of the gentlemen detailed in Section 3 above together with the company stamp bind the company in the matter of the undertakings detailed in Section 1 above, including reporting to the Registrar of Companies on behalf of the company.

May 6<sup>th</sup> 2008  
\_\_\_\_\_

Date

(signature)  
\_\_\_\_\_  
Stamp: Itamar Rosen, Adv  
No. 24634

## The First International Bank of Israel

Date: 15.09.2009

To:

AudioCodes Ltd.Subject: Undertaking to Comply with Financial Covenants

Whereas on the date 6.5.08, you signed in our favor a letter of undertaking to comply with financial covenants and other terms, as brought forth in the letter of undertaking attached to this letter of ours (hereinafter the "**Financial Covenants**").

Whereas on the date 25.11.08, you signed an amendment to the financial covenants (hereinafter the "**First Amendment**") and on the date 16.2.09 you signed on an additional amendment of the financial covenants (hereinafter the "**Second Amendment**");

Whereas and you approached us requesting our approval that until the date 31.3.10 you will not comply with the financial term set forth in Section 1.3 of the Financial Covenants, as amended in the Second Amendment and that the Second Amendment shall cease to be time limited and shall become a permanent amendment of the text in Section 1.3 of the Financial Covenants.

Therefore, at the request of the company, the bank hereby notifies that it is willing to suspend until the date 31.3.10 its right to call for immediate repayment of the company's debts due to the company's non compliance with Section 1.3 of the Financial Covenants. The bank further agrees to that the Second Amendment shall become a permanent amendment of Section 1.3 of the Financial Covenants.

It shall be clarified, this approval may not derogate from the bank's right to call for immediate repayment of the company's debts and undertakings, at any time, including during the suspension period, for any other cause. Furthermore, this approval cannot derogate from the bank's rights towards you according to any document or by the law.

The bank's abovementioned approval shall go into effect subject to the receipt of the company's written approval to the brought forth in this document.

Subject to the forgoing, all other terms brought forth in the Financial Covenants document and the first and second amendments shall stay in full force and without change.

Respectfully,

The First International Bank of Israel Ltd.

Business Department

/S/ G. Arad

/S/ Bozer Yehuda

---

To:

The First International Bank Israel Ltd.

We the undersigned approve our consent to the bank's terms as brought forth in the document and undertake to act accordingly.

\_\_\_\_\_

Audiocodes Ltd.

---

Date: 16/2/09

To:  
The First International Bank of Israel Ltd.  
Branch Ramat Gan

Dear Sir or Madam,

Whereas and Audiocodes Ltd. (hereinafter the "**Company**") received and/ or is going to receive from the First International Bank of Israel Ltd. (hereinafter the "**Bank**") credit and various banking services (hereinafter the "**Credit**");

Whereas as one of the terms to the provision of the Credit, the Company signed on the date 6.5.2008 a letter of undertaking to comply with financial covenants (hereinafter the "**Commitment Letter**");

Whereas according to Section 1.3 of the Commitment Letter we undertook, inter alia, that our cumulative operating profit for the 4 last quarters starting on the date 31/12/2008 shall be no less than a sum of \$3,000,000;

Whereas the Bank and the Company agreed to add a clarification to Section 1.3 of the Commitment Letter, as follows.

Therefore, the Company represents and warrants towards the Bank as follows:

Until the date 31/12/2009 expenses due to amortization of non tangible assets shall not be taken into account of the calculation of the operating profit.

All other commitments of the Company according to the Commitment Letter shall stay in force.

Respectfully,  
/S/ Audiocodes Ltd.  
Company's signature

We approve the abovementioned

\_\_\_\_\_  
The First International Bank of Israel Ltd.

---

Date: September 26<sup>th</sup> 2011

Att:  
The First International Bank of Israel Ltd  
Ramat Gan Branch

Re: Undertaking to comply with financial criteria - amendment of criteria

Whereas we, Audiocodes Ltd, benefit from credit and various bank services provided to us by the First International Bank of Israel Ltd (hereinafter: **“the bank”**), based on, *inter alia*, our signature on May 6<sup>th</sup> 2008 on a letter of undertaking to comply with financial criteria as it was amended on November 25<sup>th</sup> 2008, February 16<sup>th</sup> 2009 and September 15<sup>th</sup> 2009 (the original letter of undertaking and the amendments shall be called hereinafter: **“the letter of undertaking”**);

And whereas: we have requested from you additional long term credit (hereinafter: **“the additional credit”**);

And whereas: for the purpose of approving the request for the additional credit you have requested *inter alia* an amendment to the letter of undertaking as noted hereinafter and we have agreed to this;

---

Therefore, we declare and undertake the following:

1. Starting from the date of our signature on this document the following changes shall be imposed on the letter of undertaking:
  - 1.1. Our undertakings as detailed in the letter of undertaking shall apply for as long as our obligations and undertakings vis-à-vis the bank for any credit that we have received and/or shall receive from the bank and they shall be applicable in regard to any credit that we have received and/or shall receive from the bank.

Therefore, in any place in the letter of undertaking in which there is a reference to “loans” as defined in the letter of undertaking, this shall be replaced with a reference to “credit”.
  - 1.2. The second paragraph of the letter of undertaking, which starts with the words: “And whereas the company has approached you with a request to increase the credit” and ends with the words: “on the terms detailed with approval of the credit line attached as Appendix A (hereinafter: “the loans”);” shall be deleted.
  - 1.3. The first sentence of Section 1.1, which starts with the words: “The company’s equity capital” and ends with the words: “shall not be less than 15%” shall be deleted and in its place the following sentence shall be added:

“The company’s equity capital pursuant to the financial reports as detailed hereinafter shall not be less than 40,000,000 dollars and its percentage as compared to the total balance sheet shall not be less than 25%.”

1.4. At the end of Section 1.3, the following sentence shall be added:

“Expenses for the reduction of intangible assets shall not be taken into account when calculating the operating profit”.

1.5. The second sentence in Section 1.4, which starts with the words: “From the date of defrayal of the bond” and ends with the words “15,000,000 dollars” shall be deleted and in its place the following paragraph shall be added:

“From the date of defrayal of the convertible bond in entirety the overall sum received from the company’s receivable customers plus cash and plus investments shall not be less at any time than 50,000,000 dollars whereby the overall sum received from cash plus investments shall not be less at any time than 30,000,000 dollars and the balance of the cash shall not be less at any time than 15,000,000 dollars.”

1.6. The definition of the term “investments” in Section 1.4 shall be deleted and in its place the following definition shall be added:

“**Investments**” - long term deposits up to two years, negotiable bonds ranked A for a period of up to 3 years.”

1.7. Section 5 shall be deleted and in its place the following section shall be added:



“The company undertakes not to pay management fees, dividends, interest payments and/or any other payment to shareholders, and shall not defray owners loans or any part of them until the sums due from it shall be defrayed in full to the bank for the provision of credit and for as long as the obligations and undertakings of the company to the bank for provision of the credit shall not be defrayed in full.

Notwithstanding the aforementioned in this section, the company shall be permitted at any time to take any permitted action, as defined hereinafter, subject to, at any time and even after execution of the permitted action, the company complying with all its undertakings as detailed in Section 1 above.

**Permitted action**

- (1) Permitted distribution, as defined in the Companies Law, 5759-1999 (including by way of purchase of company shares, at an accrued sum that shall not exceed a total of 25 million dollars).
- (2) Payments to the stakeholder for services that the stakeholder provides and/or shall provide to the company as a “functionary” of the company, including as Chairman of the Board of Directors, President and/or company CEO.

2. As to the rest of the sections of the letter of undertaking there shall be no change and they shall remain in full force for as long as our obligations and undertakings vis-à-vis the bank shall be extant.

3. We shall request similar consent from additional banks to which we have undertaken financial undertakings, whereby the terms shall not have priority and/or harm and/or shall contradict the terms of this consent.

We undertake and declare that in the event that we shall undertake vis-à-vis another bank undertakings that shall have priority and/or shall harm and/or contradict our undertakings pursuant to the letter of undertaking and the amendment as detailed in this document (hereinafter: "the priority undertaking"), then we shall approach the bank in order to amend our undertakings pursuant to the letter of undertaking such that they shall not be inferior as compared to the priority undertaking.

4. We are aware that the consent of the bank to amend the letter of undertaking shall not derogate from our other undertakings vis-à-vis the bank including any other criteria detailed in the letter of undertaking.

(signature)

Audiocodes Ltd

Att:

The First International Bank of Israel Ltd

I confirm the content of the above letter.

Furthermore I confirm that my undertakings pursuant to the letter of undertaking which I signed on May 6<sup>th</sup> 2008 shall be applicable in regard to any credit (as defined in the letter of undertaking), including the additional credit, as defined in this document above, which Audiocodes Ltd (hereinafter: "the company") received from the bank and/or shall receive from the bank, not only as regards the "loans", as defined in the letter of undertaking, and they shall be applicable for as long as there are obligations and undertakings by the company vis-à-vis the bank as a result of the credit (as defined in the letter of undertaking), including the additional credit, as defined in this document above.

(signature)

\_\_\_\_\_  
Shabtai Adlersberg

The First International Bank of Israel

Date: 29.12.11

To:

AudioCodes Ltd. (the "Company")

Dear Sirs,

Subject: Commitment to Comply with Financial Covenants

Whereas the First International Bank of Israel Ltd. (the "**Bank**") provided the Company with credit and various banking services (the "**Credit**") relying on, inter alia, the Company's signature on 6.5.2008 on the letter of commitment to comply with financial covenants as amended on the dates 25.11.2008, 16.2.2009, 15.9.2009 and 26.9.2011 (the original commitment letter and its amendments shall hereinafter be referred to as the "**Commitment Letter**");

Whereas the Company is not complying with the financial covenants brought forth in Section 1.2 of the Commitment Letter;

Whereas in light of the Company's non compliance with its commitments set forth above, the Bank is entitled to demand immediate repayment of the loan (hereinafter the "**Referenced Cause**");

Whereas at the request of the Company, the Bank agreed not to act upon its right;

Therefore, at the request of the Company, the Bank confirms that it will not act upon its right to call for immediate repayment with respect to the financial statements for year of 2011 and for the quarterly statements the first quarter of the year 2012 (the "**Determining Statements**") due to the Referenced Cause, and this is subject to that the Company shall return to comply with all its commitments pursuant to the Commitment Letter (including the commitment brought forth in Section 1.2 of the Commitment Letter) in its quarterly statements second quarter for the year of 2012.

If the abovementioned condition was not fulfilled on the date set out for it, the Bank shall be permitted to demand the immediate repayment of the credit for the Referenced Cause.

It is hereby clarified that the abovementioned Bank's approval is limited to the Referenced Cause and in relation solely to the Determining Statements, and is subject to the fulfillment of the abovementioned condition, and it cannot derogate from the Bank's right to demand the immediate repayment of the credit for any other cause.

Notwithstanding the aforementioned, if any third party shall demand the immediate repayment of the Company's debt to it based on the Referenced Cause, fully or partially, then the Bank shall also be permitted to demand the immediate repayment.

For the avoidance of doubt, it is clarified that the Bank's consent shall not be viewed as an amendment of the Commitment Letter and all of the conditions set forth in the Commitment Letter remain in effect.

---

Respectfully,

The First International Bank of Israel Ltd.

/S/ The First International Bank of Israel Ltd

Ramat- Gan Branch

/S/ Carmi Alon

/S/ Hanan Arbel

---

The First International Bank of Israel

Date: 23.07.2012

To:

AudioCodes Ltd. (the "Company")

Dear Sirs,

Subject: Commitment to Comply with Financial Covenants

Whereas the First International Bank of Israel Ltd. (the "**Bank**") provided the Company with credit and various banking services (the "**Credit**") relying on, inter alia, the Company's signature on 6.5.2008 on the letter of commitment to comply with financial covenants as amended on the dates 25.11.2008, 15.9.2009, 16.2.2009, 26.9.2011 and 29.12.2011 (the original commitment letter and its amendments shall hereinafter be referred to as the "**Commitment Letter**");

Whereas the Company notified the Bank that it is not expected to comply with the financial covenants set forth in Section 1.3 of the Commitment Letter based on the data in the financial statements for the second quarter of 2012; and

Whereas in light of the likelihood of the Company not complying with its commitments set forth above, the Bank is entitled to demand immediate repayment of the loan (hereinafter the "**Referenced Cause**") and at the request of the Company the Bank agreed to suspend its right as set forth below;

Therefore, at the request of the Company, the Bank confirms that it is willing to suspend its right to call for immediate repayment due to the Referenced Cause, with respect to the financial statements for the period beginning from the end of the second quarter of the year 2012 and until the date the 2013 annual report is published, subject to fulfillment of the following cumulative conditions:

1. Depositing deposits as an additional collateral to guarantee the Credit, according to the following terms:

- 1.1. Until the date 31.7.2012, there shall be deposited in account number ##### which is managed in the name of the Company in the Bank's branch 041 (the "**Account**"), deposits which have a security value, according to reliance rates which shall be determined from time to time by the Bank, of no less than USD\$ 500,000.
- 1.2. In addition to the security deposit mentioned in Section 1.1 and without derogating from it, until the date of 30.9.2012, there shall be deposited in the Account deposits which have a security value, [according to reliance rates which shall be determined by the Bank from time to time,] of no less than USD\$ 500,000

(The deposits which shall be deposited as a security according to Sections 1.1. and 1.2 shall be referred to hereinafter as the "**New Deposits**");

- 1.3. Each time the Company shall deposit the New Deposits or parts thereof as set forth in Sections 1.1 and 1.2, the Company shall sign an offset and lien document regarding the funds which are used as a security, according to the form attached to this document as Addendum A.

1.4. The security value of the New Deposits shall be no less until 29.9.2012 than the sum of- USD\$ 500,000 and starting from 30.9.2012 the sum of- USD\$ 1,000,000.

(USD\$ 500,000 and USD\$ 1,000,000 shall hereinafter be referred to, as applicable, as the "**Determining Amount**")

The Bank shall determine from time to time, at its own discretion, the reliance rates for the New Deposits.

As long as the total value of security of the New Deposits, as calculated according to reliance rates as updated from time to time, shall be less than the relevant Determining Amount, the Company shall provide the Bank with additional security to the Bank's satisfaction so that the security value of the New Deposits and the additional security as determined by the Bank shall be no less the relevant Determining Amount.

## 2. **Improvement of the Operating Profit Data**

The Company shall meet the criteria set forth below, which shall reflect an improvement to the operating profit and a transition from a negative operating profit (the "**Loss**"), according to the second quarter 2012 reports to a positive operating profit for the year 2013, as follows:

According to the data of the second quarter of 2012 - the Loss shall be no greater than USD\$ 1,300,000.

According to the amount obtained from the information of the third quarter of 2012 with the additional information of the fourth quarter of 2012- the Loss shall be no greater than USD\$ 3,700,000.

According to the first quarter 2013 information - positive operating profit.

According to the second quarter 2013 information - positive operating profit.

According to the third quarter 2013 information - positive operating profit which shall be no less than USD\$ 1,500,000.

It shall be clarified that notwithstanding the provisions of Section 1.3 to the Commitment Letter, until the publication of the reports of the third quarter of 2013, an expense not exceeding USD\$ 650,000 per quarter, in respect to the accounting treatment of the intrinsic value of options to employees applied solely in accordance to FAS123, shall not be deemed a breach of the undertaking in the abovementioned section.

After the publication of the third quarter of 2013 reports, and provided that the Company will meet with all of the provisions in this document, the commitment test set forth in Section 1.3 of the Commitment Letter shall be done according to the original undertaking version, that is, loss that shall not exceed USD\$ 3,000,000 for the last four quarters each time, for accounting treatment of the intrinsic value of options to employees applied solely in accordance to FAS123, shall not constitute a breach of the criteria.

## 3. **The Existing Liens**

To guarantee the Credit, inter alia, the Company has created in favor of the Bank, liens on deposits deposited in the Account and which are registered as lien No. 1 and lien No. 5 in its review report (the "**Existing Liens**").

Whereas the credit is expected to be partially repaid during the suspension period, the Company shall commit by its signature at the edge of this letter that during the suspension period the Company shall not request of the Bank to reduce the amount of pledged deposits with the Existing Liens. The Existing Liens shall continue to ensure the entire Credit as shall be at any time in accordance to the original terms.

Notwithstanding the forgoing, if partial repayments shall be made, the Company shall be permitted to request the Bank to reduce the amount of pledged deposits with the Existing Liens subject to simultaneously creating in favor of the Bank a lien on Foreign Securities, as defined below, and/ or on securities traded on the Tel Aviv Stock Exchange whose total security value according to the reliance rates as determined by the Bank at such time shall be no less than the requested reduction amount.

It shall be clarified that what is stated in this section does not require the Company and/ or the Bank to any changes in the terms of the Existing Liens and does not require the Bank to agree to the Company's request to reduce the amount of pledged deposits with the Existing Liens. To the extent that the Company shall make such requests from the Bank, the Bank shall consider and shall be permitted to grant or deny such a request, and/or to stipulate its consent according to certain conditions which shall be determined by the Bank at any such relevant time.

**Foreign Securities-** for purposes of this document, bonds with a duration that shall not exceed 3 years, which are traded outside of Israel and are rated by the rating agencies Moody's and/or S&P with a rating of (-A) and higher.

If one of the above criteria is not complied with at the prescribed date, the Bank may demand immediate repayment of the Credit for the Referenced Cause.

It is hereby clarified that the mentioned approval of the Bank is limited to the Referenced Cause and solely with respect to the reports from the end of the second quarter of the year of 2012 and until the publication date of the annual reports of 2013, and it does not derogate from the Bank's right to demand the immediate repayment of the Credit for any other cause, including during the suspension period.

Notwithstanding the forgoing, if any third party demands immediate repayment of the entire debt, or a portion of the debt, of the Company due to the Referenced Cause then the Bank may also demand the immediate repayment of the Credit.

For the avoidance of doubt, it is emphasized that except as provided above in Sections 1, 2 and 3, and as detailed in those sections only, the Bank's consent may not be viewed as an amendment of the Commitment Letter and all of the conditions set forth in the Commitment Letter remain in effect.

Respectfully,

The First International Bank of Israel

Ramat- Gan Branch

/S/ Tankel Liat

/S/ Hanan Arbel



## The First International Bank of Israel

Addendum A

Branch \_\_\_\_\_

Date \_\_\_\_\_

**Offset and Lien Document for Funds Used as Security**

**Whereas** and the undersigned (the "**Account Holders**") owe and/or may be in debt towards the Bank, from time to time, either as main debtors or as guarantors, the debt sums as defined herein; and

**Whereas** it has been agreed between the Account Holders and the Bank that in order to ensure the debt amount the Bank shall have the following specified rights;

Now, therefore, the Account Holder irrevocably declares and confirms the following:

## 1. Definitions:

In this document the following terms shall have the following meaning:

**"Bank"**- the First International Bank of Israel Ltd. and any one of its branches or offices which exist on the date of this document or that shall be opened in the future, either in Israel or outside of Israel.

**"Account Holders"**- those who are listed in the Bank's books, at any relevant date, as the account holders.

**"Debt Amount"**- all of the sums that are owed, and that shall be owed, to the Bank from the Account Holders from time to time, in any event or case, including for credit, including principal, interest, linkage differentials (if those shall exist, due to the linkage of the principal and the interest, or any of them, to any exchange rate, or to the consumer's price index or to any other index), commissions, taxes and expenses. The Debt Amount includes amounts that are due, or shall be due, from the Account Holders, either as main debtors or as guarantors, either in their name, or in their business's name, or by any other name, either by the current composition of the Account Holders and either by any other composition, either if the owed sums are owed or shall be owed by the Account Holders together or separately, whether if by the Account Holder alone or from the Account Holders with another/others, including in another account of the Account Holders at the Bank. The Debt Amounts include sums as aforesaid whether they are a fixed amount and whether they are not fixed, whether they shall be paid by the Account Holder directly or indirectly, in a specific way, on condition or any other way, whether their date of repayment has arrived and whether the date of repayment has yet to have arrived, including for checks and/ or signed bills, in their endorsement or guaranteeing, whether if the aforesaid sums, or parts of the sum, were adjudged by any judicial authority or not, and including a case of a conditional charge where the condition or conditions has/ have yet to have been met.

**"Credit"**- either in Israeli currency or in foreign currency, either in the country or out of the country, including return credit, one-time credit, loans, overdrafts, documentary credit, providing of guarantees or letters of indemnification, handling of cargo notes, actions in securities, discounting notes, note purchasing, note brokering, advance payments, provision of extensions, purchase of risk participation, future transactions and any transaction, or service, or any other action of any sort, which as a result form, or are capable of forming, any debts or obligations of the Account Holders to the Bank.

2. To ensure the Debt Amount, the Bank shall have the right, lien and offset over all of the funds which have been/will be agreed upon between the Bank and the Account Holders, from time to time, that will serve as a security for the Debt Amount, entirely or partially, either in Israeli currency or foreign currency, which are owed or which shall be owed to the Account Holders, whether alone or together with others, in any way or claim, for their consideration, its income], including on the rights of the Account Holders related to all these, and including on rights owed to the Account Holders for future transactions (hereinafter all shall together and separately be referred to as the "**Financial Collateral**").
3. As long as the Account Holders have not repaid the Bank the entire Debt Amount, the Account Holders shall not be permitted to withdraw the financial guarantees or parts thereof, without the Bank's consent.

The Bank shall be permitted to retain the Financial Collateral, entirely or partially, until the complete clearing of the Debt Amount.

4. The Account Holders shall not be permitted to pledge or mortgage under any priority, to transfer, impart, sell, endorse, or assign the Financial Collateral or their rights that derive from the Financial Collateral or parts thereof, either directly or indirectly, either for consideration or not for consideration without having received for this prior written approval of the Bank. Actions of the Account Holder that contradict this section shall be considered null and void from the outset.
5. A. Without limiting the Bank's rights according to this document, the Bank shall be permitted (but not obligated), from time to time, without the need of prior notification, to set-off any amount of the Debt Amount which has reached its maturity date (including any amount of the Debt Amount which has reached its maturity date due to immediate repayment and/or acceleration of repayment in accordance to the law and/or as agreed upon with the Account Holders) against the financial guarantees, entirely or partially, even prior to the maturity date of the Financial Collateral that are to be set-off against.  
  
B. To exercise its aforementioned rights, the Bank is permitted, inter alia, to sell any sum of foreign currency which consists a portion of the Financial Collateral and/or to purchase foreign currency for the clearing the Debt Amount or parts thereof, and this is according to a rate of transfers and assigns or any other rate as customary by the Bank, with a deduction or addition, as applicable, of exchange commission and any tax, excise, compulsory payments or other payments.
6. The Account Holders shall have no action or claim of any type or kind against the Bank for any of the actions listed in this document, including due to the Bank's exercise of rights date and due to the consideration that has been received on account of the Financial Collateral. Without derogating from the generality of the aforesaid, the Account Holders are aware that in cases where the Bank shall use its forgoing rights prior to the repayment date of the Financial Collateral, entirely or partially, their rights may be harmed according the terms of the deposit of that collateral, including their rights to interest, linkage differences, exchange rate differences, benefits, loans, exemption from taxes and other rights, and they exempt the Bank from any responsibility for damage and/or loss which may be caused as a result of the aforesaid Bank's exercise of rights.
7. The provisions of this document are irrevocable and may not be terminated or changed without the prior consent of the Bank to that, as the Bank's rights are dependent on it.
8. The Bank's rights as of this document are in addition to its rights, including lien and set-off, by any law, according to the general terms of account management and/or the general debit agreement], and by any other document which has been signed or will be signed by the Account Holders towards the Bank, and this document does not derogate any right which has been granted to the Bank by any law or any other document.
9. This document obligates all of the signatories jointly and severally.

In witness the Account Holders signed:

\_\_\_\_\_

Details of the financial securities, correct as of the date \_\_\_\_\_

<u>Account Number</u>	<u>Deposit</u>	<u>Amount</u>
-----------------------	----------------	---------------

Date: July 14<sup>th</sup> 2008

Att:  
Bank Mizrahi Tefahot Ltd (hereinafter: "the bank")  
Branch 018

Dear Sir or Madam,

Whereas AudioCodes Ltd (hereinafter: "the company") approached us with a request for long term loans totalling 15,000,000 dollars which will be provided to the company account No. ##### (hereinafter: the loans");

And whereas Shabtai Adlersberg holds company shares and is a stakeholder in the company as detailed in his report to the Securities Authority in the United States in February 2008 attached as an integral part of this letter and as the term "stakeholder" is defined in the Securities Law 5728-1968 (hereinafter: "the stakeholder");

And whereas as one of the conditions of provision of loans the bank has requested that the company and the stakeholder shall sign on this document and on the undertakings detailed hereinafter, and the company and the stakeholder agreed to this;

Therefore, the company declares and undertakes vis-à-vis the bank that for as long as the company has obligations and undertakings vis-à-vis the bank for provision of the loans, all the following shall be imposed:

---

1. The company shall comply at all times with the conditions and the financial criteria hereinafter, which shall be examined pursuant to the company's quarterly consolidated financial reports (the annual reports shall be audited pursuant to US GAAP or various rules of standardization that shall replace them).
- 1.1. The company's equity capital according to the financial reports as detailed hereinafter shall not be less than 25,000,000 dollars and its percentage as compared to the total balance sheet shall not be less than 15%. Starting from the balance sheet of December 31<sup>st</sup> 2009 the company's equity capital, as detailed hereinafter, shall not be less than 30,000,000 dollars and its percentage compared to the balance sheet shall not be less than 15%.

Equity capital - as it appears in the company's financial reports (including *inter alia* the company's defrayed equity capital, capital funds, balance of the undesignated profit less the cost of the company shares held by it or by subsidiaries and plus/less any other clause included within the framework of the company equity clause in the financial reports) and plus deferred owners loans, and less loans given to affiliated parties and less intangible assets as they shall appear in the company's financial reports.

[In this matter, affiliated parties is as defined in Manifesto No. 29 in regard to affiliated parties, by the Institute of Chartered Accountants in Israel.]

Sums that shall be deducted from the equity capital for the purpose of calculating the equity capital as defined above, shall also be deducted from the total balance sheet for the purpose of calculating its percentage, as required in the preface of Section 1.1 above.

- 1.2. The company's total bank financial undertakings shall not exceed \$30,000,000. It is hereby clarified that the company's 2% Senior Convertible Notes Due 2024 ("convertible notes") shall not be considered as financial undertakings. Without derogating from that stated in Sections 4-5 hereinafter, the company shall be permitted to defray the current payments due from it to its creditors including to the convertible note holders and this during the regular course of business and pursuant to the agreements with them and the dates detailed therein. The aforementioned shall not derogate from the fact that the bank is a secured creditor and therefore at the time of realization of liens given by the company in favour of the bank the secured creditors (including the bank) shall collect from the considerations of the realization the monies due to them before unsecured creditors including the convertible note holders.

The bank financial undertakings are defined as loans (short term and long term) from banks and other financial institutions.

- 1.3. The accrued operating profit (US GAAP) for the last 4 quarters starting from December 31<sup>st</sup> 2008 shall not be less than \$3,000,000. Notwithstanding the aforementioned, a loss of up to \$3,000,000 that shall be caused for an accounting record for the value of the benefit entailed in granting options to employees pursuant to FAS123 shall not constitute a breach of the criteria.

1.4. Until the date of realization of the options for defrayal of the convertible note (Security No. 050732AB2) (hereinafter: "the bond") in November 2009, the overall total received in cash (as defined hereinafter) plus investments (as defined hereinafter) shall not be less at any time than 120,000,000 dollars; the balance of cash shall not be less at any time than 15,000,000 dollars.

From the date of defrayal of the bond the overall sum received from receivable customers of the company plus cash plus investments shall not be less at any time than 40,000,000 dollars whereby the overall sum received from cash plus investment shall not be less at any time than 20,000,000 dollars and the balance of the cash shall not be less at any time than 15,000,000 dollars.

Cash - as it appears in the company's financial reports including cash and cash equivalents, short term deposits for a period of up to one year.

Investments - long term deposits up to two years, convertible bonds ranked A+ for a period of up to two years.

The company declares that as of the date of signature on this document it is complying with the terms and the financial ratios determined in Section 1 above.

2. The company undertakes that inasmuch as it shall apply accounting rules that are different than those applied by it on the date of signature on this letter of undertaking, the company shall approach the bank to correlate its undertakings pursuant to Section 1 above with the changes derived from the application of the rules. In the event that the company and the bank shall not reach an agreement in regard to the changes required within 30 days from the date that the company approached the bank or within another period determined between the parties, this shall be cause to consign the company's obligations and undertakings for immediate defrayal.
3. If there shall be no change to the stakeholder's holdings in the company as such that he shall reduce his holdings to under the percentage of the holdings required pursuant to the Securities Law 5728-1968 for the purpose of definition of a stakeholder, without the consent of the bank in advance and in writing.
4. The loans which the company received and/or shall receive from the stakeholder in the company (hereinafter: "the owners loans") shall be inferior and deferred from the company's obligations and undertakings to the bank for provision of the loan, and the obligations and undertakings of the company vis-à-vis the bank for provision of the loans shall have priority as compared to the owners loans as they shall be at any time. To avoid doubt, it is hereby clarified that the services that the stakeholder provides and/or shall provide to the company as a "functionary" of the company, including as the Chairman of the Board of Directors, President and/or company CEO, shall not be considered as an owners loan, and the company's obligations and undertakings vis-à-vis the bank shall not have priority as compared to these services, and the company shall be permitted to pay the stakeholder for these services without any restriction.



5. The company undertakes not to pay management fees, dividends, interest payments and/or any other payment to shareholders, and not to defray owners loans or any part of them until the sums due from it to the bank for provision of the loans shall be defrayed in full, and for as long as the company's obligations and undertakings to the bank shall not be defrayed in full for provision of the loans. To avoid doubt it is hereby clarified that the company is not restricted (a) in buying company shares and/or the company's convertible notes on condition that the company is complying with the terms and financial ratios determined in Section 1 above; (b) the payment of interest and/or other payments is imposed and/or shall be imposed on the convertible note.
6. We hereby undertake that we shall not sell and/or transfer and/or deliver and/or lease and/or rent (hereinafter jointly and severally - transfer) any assets whatsoever (including monies), in any shape or form, as they are at present and as they shall be in the future, in entirety or in part, from our ownership and/or our possession during an entire consecutive period of 12 months, whereby the value of the assets exceeds 1 million US dollars (or equivalent in foreign currency and/or in NIS), which is not during the regular course of business and in return for full consideration to third parties (including to those who are our shareholders directly or indirectly), without the consent of the bank in writing and in advance.

7. We hereby undertake that we shall not execute purchases/investments of any type whatsoever of/in companies and/or of/in assets and in any form whatsoever, whether indirectly or directly, whereby the sum of the purchase/investment exceeds 10 million US dollars (or equivalent in foreign currency and/or in NIS, pursuant to the type of investment) during a consecutive period of 12 months, without notifying the bank in writing and in advance. A notice to the bank shall not be given before a notice to the public if such shall be required.
8. The company shall provide the bank close to receipt of its request for such, reports, documents and current information in regard to the company's business and its financial status. Without derogating from the generality of the aforementioned, the bank shall be provided with, *inter alia*, starting from the date of signature on this document current reports as follows:
  - 8.1. Within 180 days from December 31<sup>st</sup> of each year the company shall transfer to the bank all its financial reports for December 31<sup>st</sup> of the year ending, whereby the aforementioned reports are audited by an external CPA.
  - 8.2. Within 75 days from the last day of each of the months March, June, September, December of each year the company shall transfer to the bank all the company's notices to the press regarding the summary of the financial reports relating to the calendar quarter ending on the last day of each of the aforementioned months including an amendment report as regards the equity capital which were prepared according to accepted accounting principles (US GAAP).

- 8.3. Within 30 days from the last day of each quarter the company shall transfer to the bank details of receivables (including customers in Israel, overseas, various receivables and its debts to creditors with priority) and debit balances in the banking system. The figures shall relate to the last day of each quarter.
- 8.4. Within 30 days from the last day of each quarter the company shall transfer to the bank a report on the composition of the company's investment portfolio including the ranking of the securities constituting the company's investment portfolio. The report shall be signed by the company and shall contain the company's reference to its compliance with the criteria detailed in Section 1.4 above.
- 8.5. If the company shall prepare additional financial reports in Israel and overseas, audited or unaudited and/or additional financial reports such as prospectuses, business plans and so forth, presented to any entities whatsoever in Israel or overseas and published by the company, the company shall transfer to the bank copies of these reports immediately that they are prepared.
- 8.6. Without derogating from the above-mentioned in this section, the bank's representatives shall be permitted to meet with the company's CPA at any time at their request for the purpose of ascertaining the financial status of the company.

For the purpose of this document the term "financial reports" means - balance sheet, profit and loss report, cash flow report, amendments to equity capital report including annotations which were prepared and audited pursuant to the accepted rules of accounting (US GAAP).

9. The company shall inform the bank immediately in regard to any claim or legal proceeding exceeding one million dollars of any type whatsoever that has been filed or has been opened in a court, tribunal or in any other judicial institution, in Israel or overseas.
10. The company is aware that in any event of a breach of one or more of its undertakings pursuant to this document, including in the event of a breach derived from application of rules of regulation different from the rules implemented by it on the date of signature on this undertaking, in part or in full, then in addition to any other relief that the bank shall be entitled to pursuant to any document signed and/or that shall be signed by the company and subject to the company's right to remedy these breaches if and inasmuch as they exist and/or subject to any law, the bank shall be permitted, but not obligated, to consign for immediate defrayal the sums due to it from the company for provision of the loans, in entirety or in part, and to realize any security and/or guarantee provided to it and/or for it by the company.
11. Any undertaking by the company and the stakeholder pursuant to this document and all the bank's rights pursuant to it are in addition to and independent from the undertakings, securities and guarantees that the bank received and/or shall receive from the company and/or from the stakeholder and/or from either of them, and shall not affect them and shall be not be affected by them.

12. The bank's waiver for any prior breach whatsoever or for any previous non-compliance whatsoever of one or more of the undertakings to it, whether that same undertaking is included in this document or whether it is included or shall be included in any other document whatsoever, shall not be considered as justification for an additional breach or additional non-compliance with any term or undertaking as aforementioned; and the avoidance of the bank from realization of any right whatsoever awarded to it pursuant to any document whatsoever and/or pursuant to any law, shall not be interpreted has a waiver of that same right.
13. To avoid doubt it is hereby clarified that nothing stated in this document shall derogate or diminish in any way whatsoever any undertaking by the company and/or of the stakeholder and/or either of them vis-à-vis the bank and/or from any right or duty whatsoever by the bank vis-à-vis the company and/or vis-à-vis the stakeholder pursuant to agreements with the bank including the general terms for administering an account, general terms for credit activity and any other document which has been signed and/or shall be signed by them and/or by any of them.

Yours sincerely

(signature)  
Company signature

(signature)

Stamp: AudioCodes Ltd

I the undersigned, am the shareholder/stakeholder and Company CEO of Audiocodes Ltd (hereinafter: “the company”) confirm and undertake to you as follows:

1. I confirm my consent to provision of the aforementioned undertakings by the company.
2. I undertake not to cause or to agree to a change in the percentage of my holdings in the company, which would reduce my holdings to under the percentage of holdings required pursuant to the Securities Law, 5728-1968 for the purpose of definition of a stakeholder, including by way of transfer of shares and/or allocation of shares and/or by any other method and to change the identity of the stakeholder as such that it shall cause the company to breach its undertakings as detailed above.
3. I hereby agree and undertake that the loans which the company has received and/or shall receive from me (hereinafter - “the owners loans”) shall be inferior and deferred from the company’s obligations and undertakings to the bank for provision of the loans and that the company’s obligations and undertakings vis-à-vis the bank for provision of the loans shall have priority as compared to the company’s obligations to me for the owners loans as they shall be from time to time, and that the company and/or its representative and/or anyone in its name shall pay and defray to the bank all the obligations and undertakings to the bank, and this prior to defrayal of the owners loans as they shall be at that time. To avoid doubt it is hereby clarified that the services that the stakeholder provides and/or shall provide to the company as a “functionary” of the company, including Chairman of the Board of Directors, President and/or company CEO shall not be considered as owners loans, and the company’s obligations and undertakings vis-à-vis the bank shall not have priority as compared to these services and the company shall be permitted to pay the stakeholder for these services without any restriction.

4. Without derogating from the aforementioned in Section 3 above I hereby undertake not to request and not to receive from the company in any way whatsoever payments on account of defrayal of the owners loans, or any part of them, for as long as all the company's obligations and undertakings have not been defrayed to the bank for provision of the loans. To avoid doubt it is hereby clarified that the company shall be permitted to pay the stakeholder for the services that the stakeholder provides and/or shall provide to the company as a "functionary" of the company, including as Chairman of the Board of Directors, President and/or company CEO without any restriction.
5. I hereby undertake that in the event that, for any reason whatsoever, I shall receive any payment whatsoever on account of defrayal of the owners loans, and this when on that same date all the company's obligations and undertakings vis-à-vis the bank have not been defrayed to you in full for provision of the loans, I shall pay and defray you any sum that shall be paid to me and/or shall be received by me on account of defrayal of the owners loans as aforementioned.
6. My aforementioned undertakings shall be rescinded on cancellation of the company's aforementioned undertaking without any additional notice.

Date: July 14<sup>th</sup> 2008

Name: Shabtai Adlersberg

Signature: (signature)

**Bank Mizrahi Tefahot Ltd****Secured Bond**

Signed on the 14<sup>th</sup> of the month of July in year 2008

By: Audiocodes Ltd (hereinafter: "the company")

Address: 1 Hayarden, Airport City

In favour of Bank Mizrahi Tefahot Ltd (hereinafter: "the bank") pursuant to the Memorandum and Articles of Association of the company and the rest of the provisions providing the company with the referred power and pursuant to the resolution of the company's Board of Directors dated July 3<sup>rd</sup> 2008.

Whereas the company has received and shall receive from time to time from the bank, credit, documentary credit, various loans, overdraft facility for a checking account, for a current loan account or other account, writs of indemnification, any undertakings and guarantees whatsoever for the company or for others at the request of the company. Discount of notes, provision of various extensions and banking easements and various other banking services (hereinafter - jointly and severally - "the banking services") on the terms that have been agreed and/or shall be agreed from time to time as regards any banking service.

---



And whereas it has been agreed between the company and the bank that the company shall guarantee all its debts and undertakings to the bank in any shape and form whatsoever, whether in Israeli currency or any foreign currency whatsoever and of any type whatsoever as detailed hereinafter - by this bond and this in addition to all the securities that have been given and/or shall be given to the bank.

Therefore this bond testifies to the following:

1. ..
  - a) This bond has been issued to guarantee full and accurate payment of all the sums, whether in Israeli shekels or in any foreign currency whatsoever, due or that shall be due to the bank from the company by any means, form, method and reason whatsoever, whether the sums are due from the company in relation to the banking services or not, whether they are due from the company alone or together with others, whether the company has already obligated to them or shall obligate to them in the future, as an obligant and/or as a guarantor and/or for any other reason (including the company's liability pursuant to notes that have been transferred or shall be transferred to the bank whether by the company or by third parties for discount or security and/or pursuant to any other liability of the company vis-à-vis the bank) which are due and/or shall be due in the future, which are consigned for defrayal prior to realization of the securities hereby provided or later, which are due absolutely or conditionally, due directly or indirectly, due pursuant to the original undertaking of the company or consolidated pursuant to a court ruling or other -

\* Without limit to the sum

\_\_\_\_\_ Signature

plus interest, commission fees, various expenses including realization expenses, attorneys fees, insurance fees, stamp duty and other payments pursuant to this bond combined with linkage differences of any type due and that shall be due from the company to the bank by any method or means for linked capital and interest (all the aforementioned sums shall be called hereinafter: "the secured sums").

- b) Secured sums due or that shall be due to the bank from the company in any foreign currency whatsoever shall be considered to be secured by this bond, solely and only in the event that for the transaction according to which they are due or shall be due, an appropriate permit has been given in advance, or retrospectively, from the authorized authorities in Israel, inasmuch as such permit is required by law.

2. The company hereby undertakes to pay the bank any sum of the secured sums:

- a) On the agreed date of defrayal, if it has been agreed between the bank and the company that that same sum shall be consigned for defrayal on a certain date.
- b) Seven days after the date of sending the first request by the bank in writing to the company, if the date of defrayal has not been agreed as abovementioned in Paragraph (a).

3. ..
- a) The bank is permitted not to receive early payment of the secured sums or any part of them before the date of defrayal has arrived.
- The company or anyone whose right could be harmed by provision of this bond or its realization, shall not have the rights pursuant to Article 13(b) of the Pledge Law 5727-1967 or any other law.
- b) In any event in which the bank shall accede to the company's request for early defrayal of any payment whatsoever on account of the secured sums, it shall be permitted to charge the company for the sums that shall express the damage that shall be caused to the bank due to the early defrayal.
4. ..
- a) The bank shall be permitted to calculate the interest on the secured sums at a rate that has been agreed or shall be agreed from time to time between it and the company. In cases in which the rate of interest has not been agreed the bank is permitted to determine the rate of the interest and advise the company of this. The company shall be charged for the aforementioned interest rates and the bank is permitted to add them to the capital at the end of each quarter year or at the end of any other period, as the bank shall determine.

- b) In any event of delay in payment of the secured sums in entirety or in part, the secured sums shall bear interest in arrears at a rate that has been agreed in the agreement for provision of banking services. If there is no determination in regard to interest in arrears in these agreements, the secured sums shall bear interest at the maximum rate that shall be customary in the bank as regards to overdrafts and arrears for a current loan account and no less than 2% above the fixed rate of interest in the agreement for provision of banking services.
  - c) In any case that awards the bank the right to realize the securities pursuant to this bond, the bank shall be permitted to raise the interest rate on the secured sums up to the maximum rate that shall be customary in the bank at that time for overdrafts and arrears for a current loan account.
5. To secure the full and accurate defrayal of all the secured sums, the company hereby pledges in favour of the bank and its substitutes -
- a) By a first degree floating lien on the entire factory, equipment, assets, monies, property and rights including their proceeds, of any type whatsoever without exemption that the company has at present or that it shall have in the future at any time whatsoever in any shape or form including insurance rights for them, the rights pursuant to the Property Tax and Compensation Fund Law 5721-1961 and all rights to compensation or indemnification that the company shall have vis-à-vis any third party due to loss, damage or expropriation of its property or any part of it (hereinafter: “the attached assets”).
  - b) By a fixed first degree lien and a pledge its goodwill, as it shall be at present and as it shall be at any time (hereinafter: “the attached goodwill”).

- c) Deleted.
- d) By a fixed first degree lien all the rights, including intellectual property rights of the company as detailed in Appendix A, including those detailed in the list noted in Section 7(n) (hereinafter: "the attached intellectual property rights").
- e) By a fixed lien and by a pledge the bills of lading - by sea or air - certificates of ownership of goods, storage certifications, delivery certifications, order of goods, documentary letters of credit, postal receipts or any other documents customary in international commerce which testify to ownership of goods or merchandise (hereinafter: "the documents") which shall be transferred, if it shall be transferred, from time to time to the bank, for collection, for custody, for security or other, including all the insurance rights in any shape or form vis-à-vis the Israeli Foreign Trade risks Insurance Corporation Ltd. or any other insurance company, as well as any right for compensation or indemnification that the company shall have vis-à-vis third parties due to failure, damage, loss or expropriation of the goods or the merchandise - upon their transfer to the bank as aforementioned they shall be considered to be attached and pledged to the bank within the pledge and the first degree fixed lien pursuant to the terms of this bond and its provisions.

- f) By a fixed lien and by a pledge of all those same securities, documents, notes of others which the company transferred or shall transfer from time to time to the bank whether for collection, custody, security or other (hereinafter: “the attached documents”) and on their transfer they shall be considered as pledged and attached to the bank as a pledge and first degree fixed lien pursuant to the terms of this bond, and its provisions, with the appropriate changes, shall be imposed on their attachment and their pledge.

The bank shall be exempt from taking any action whatsoever in regard to the attached documents and shall not be responsible for any damage that shall be caused in regard to this, and the company undertakes to indemnify the bank in any event in which the bank shall be prosecuted for such damage by others. The company hereby waives in advance any claims of limitation in regards to the attached documents.

- g) “The attached assets”, “the attached goodwill”, “the attached intellectual property” “the documents” and the “attached documents” and any other lien noted in this section shall be referred to hereinafter as “the attached property”.

6. The company hereby declares the following:

- a) That the attached property is not attached or pledged to others or confiscated in any way whatsoever, apart from that detailed hereinafter:

Attached in favour of Bank Leumi

---

---

---

- b) That the attached property is under its exclusive ownership and possession, or in the possession of the bank.
- c) That there is no restriction or condition pursuant to law or agreement or other, imposed on transfer of the attached property or on its attachment or its pledge.
- d) That it is permitted to pledge or attach the attached property by any method.
- e) That there has been no transfer of rights or other action derogating from the value of the attached property.
- f) That it received all the agreements and/or waivers required (inasmuch as required) from the shareholders or the investors pursuant to the company's Articles of Association or various investment agreements.

7. The company hereby undertakes vis-à-vis the bank as follows:

- a) To keep the attached property in its possession.
- b) To use and handle the attached property with exceptional care and to inform the bank about any incident of damage or malfunction that shall occur in them and to repair any damage or defect or malfunction that shall be created in the attached property due to use and/or for any other reason and to be responsible vis-à-vis the bank for any incident of breakdown, damage, defect or malfunction as aforementioned and all apart from reasonable wear and tear.

- c) To allow the bank's representative at any time to visit and examine on site the condition of the attached property at its location.
- d) Not to sell, lease, transfer to another location, to transfer by any means or method to another the attached property or any part of it - apart from for sales, transfers and leasing of the business inventory carried out during the normal course of business in the company - without receiving consent in advance and in writing from the bank.
- e) Not to sell, not to lease, not to transfer to another location, not to transfer to others and to give to others the right of use of the attached assets without receipt of consent for this in advance and in writing from the bank.
- f) To immediately inform the bank of any incident of imposition of a confiscation on the attached property and/or the attached assets and/or any part of them and to immediately inform the confiscator of the lien in favour of the bank and to take on the account of the company immediately and without delay all the means required to remove the confiscation. If the company shall not take the aforementioned steps, the bank shall be permitted (but not obligated) to take all the means to remove the confiscation and the company shall be required to pay the bank immediately all the reasonable expenses entailed in this (including the bank's attorneys fees).



- g) Not to attach in any way whatsoever the attached property or any part of it with equal, prior or later rights than the bank's rights and not to assign any right whatsoever that the company has to the attached property without receipt of consent for this in writing and in advance from the bank.
- h) To be responsible for the veracity and accuracy of all the signatures, endorsements, and details on notes, documents and securities that were transferred and/or shall be transferred to the bank as a security.
- i) To pay in a timely fashion all the taxes, municipal taxes, levies and other mandatory payments imposed on the attached property pursuant to any law and to present to the bank at its first request a copy of all the receipts for the abovementioned payments, and if the company shall not pay the aforementioned payments as abovementioned in a timely fashion, the bank shall be permitted to pay them on the account of the company and to charge them for the payments together with expenses and interest at the maximum rate. These payments are secured by this bond.
- j) To administer its accounting books and to allow the bank or a representative on its behalf coordinated in advance to examine the books. The company undertakes to assist the bank and its representatives to transfer to them at their first request, balance sheets, documents and any information that they shall require, including explanations in regard to the financial and operating status of the company and/or its businesses.

- k) That there shall be no fundamental change in the area of the company's occupation without the consent of the bank in writing and in advance.
- l) The company is the owner and/or the owner of the rights of use pursuant to license or agreement of all the intellectual properties required for the company for the purpose of its business.
- m) To the best of its knowledge the company is not infringing at present and there is no proceeding as regards infringement of intellectual property against it by any third party.
- n) The company is hereby attaching a complete list of all the intellectual properties and shall present to the bank in writing any update or change that shall occur to the list. Furthermore the company shall update the list of accounts receivables every six months. Following the company's reports as abovementioned an update shall be performed for the liens at the relevant registrars and the company shall sign on the customary documents in this matter.

8. For as long as this bond is valid the company undertakes with respect to itself and with respect to its subsidiaries as follows:

- a) Deleted.

- b) Not to pay to shareholders in any shape or form whatsoever any loan or monies that the shareholders shall lend the company or any monies that the aforementioned invested and/or shall invest in the company. The abovementioned shall not be imposed on a loan given for conversion to company shares which shall be redeemed by allocation of shares.
- c) Not to give shareholders any loan or credit without the consent of the bank in writing.
- d) To ensure that the shareholders who loaned and/or shall loan owners loans to the bank shall undertake vis-à-vis the bank not to demand and not to claim for the abovementioned monies from the company, and if for any reason nevertheless they shall receive sums from the company - to return the abovementioned sums to the bank to serve for defrayal of the abovementioned sums.
- e) Not to purchase its shares and not to pay any dividend whatsoever without the consent of the bank in advance and in writing.

9.

..

- a) The company hereby undertakes to maintain at any time the attached property insured for its full value against those same risks that the banks shall advise from time to time with insurance companies and to transfer to the bank to the limit of the sum of this bond the rights derived from the insurance certificates, according to wording approved by the bank, to pay all the insurance fees on time and to transfer to the bank all the insurance certificates and the receipt for payment of the insurance fees.

- b) Without derogating from the aforementioned and further to it, the company hereby undertakes to give the insurance company through which it is insuring the attached property, an irrevocable instruction to transfer all the monies that shall be due to the company pursuant to the insurance policy for the attached property to the borrower's account at the bank only. Also the company undertakes to present to the bank an undertaking by the abovementioned insurance company and to inform the bank of the date of expiration of the validity of the insurance policy for as long as it shall be issued by it, at least 30 days prior to the date of expiration.
- c) In each of the events noted hereinafter the bank shall be permitted, at its sole discretion, to insure the attached property on behalf of the bank and to charge the company's account for the expenses for insurance fees:
  - (1) If the attached property shall not be insured to the satisfaction of the bank.
  - (2) If the company shall not present to the bank within 10 days from the date of signature on this bond, insurance certificates for the attached property to the sole satisfaction of the bank.

- (3) If 30 days before the end of the validity of the insurance for the attached property, the company shall not present to the bank insurance certificates for the attached property on the same conditions and for the same term to the full satisfaction of the bank. In the event that the insurance shall be executed by the bank as abovementioned, the bank shall not be responsible for any defect or fault that shall be discovered as regards to the insurance. Sums that shall be paid as an expense and as the aforementioned insurance fees are secured pursuant to this bond.
- d) All the rights derived from the insurance of the property as aforementioned, including rights pursuant to the Property Tax and Compensation Fund Law 5721-1961 as shall be in force from time to time or pursuant to any other law, whether they were transferred to the bank as aforementioned or not, are hereby attached by a fixed first degree lien and pledge.
- e) As regards the insurance of the company property the company hereby appoints the bank as its sole representative and it awards it the exclusive rights to conduct negotiations in the name of the company and to agree to arrangements, to compromise, waive, receive monies from insurance companies and to credit them for defrayal of the insured sums; the aforementioned power of attorney is irrevocable as third party rights are dependent upon it, the company shall not have any claims as regards the arrangements, waivers, compromises that the bank shall make with the insurance companies.
- f) The company undertakes to sign, at the bank's first request, on all the requests, documents and certificates required or desired for the purpose of executing all the company's undertakings incorporated in this section. Furthermore the company undertakes not to cancel or change in any way whatsoever any of the terms of the abovementioned insurance without the consent of the bank in advance and in writing.

10. ..
- a) The securities given to the bank pursuant to this bond are continuous notwithstanding the arrangement for accounts or for any of the company's accounts and shall remain valid until the bank confirms in writing that this bond is cancelled.
  - b) If the bank has been given or shall be given securities or guarantees to defray the secured sums, the securities and the guarantees shall be independent of each other.
  - c) If the bank shall compromise or shall give an extension or an easement to the company, the bank shall amend the company's undertakings as regards the secured sums, shall release or shall waive other securities or guarantees - the abovementioned shall not change the essence of the securities created pursuant to this bond, and all the company's securities and undertakings pursuant to this bond shall remain fully in force.
11. The bank has the rights of possession, stay and set off for all the sums, the assets and the rights, including securities, coins, gold, bank notes, negotiable documents, insurance policies, bills, cheques, charges, deposits, securities and their consideration, that shall be found in the bank at any time to the company's credit or for it, including those that were transferred for collection, security, custody or in another fashion. The bank is permitted to retain the aforementioned assets until full defrayal of the secured sums or to sell them and to use their consideration, in entirety or in part, for defrayal of the secured sums.

In the event that the set off sums are deposited in foreign currency the company hereby gives the bank authorization and instructions in advance to sell the balance of the rights to credit the foreign currency according to exchange rate that the bank shall achieve for it.

12. The bank shall be permitted at any time to charge any company account with you for any sum due or that shall be due to it from the company and the company shall accredit any sum that it shall receive from the company or for it to credit that same account that it shall see fit to transfer any sum that it shall provide to the company in any account whatsoever with it and any other account with it as the bank shall see fit.
13. Taking into account that the sums due and that shall be due to the bank from the company on account of secured sums can be both in Israeli currency and foreign currency, it is hereby agreed and declared that the bank and the receiver - accordingly - shall be permitted to convert the Israeli currency that shall be available to them into the foreign currency required to defray in full or in part the secured sums due to the bank in foreign currency, and shall convert the foreign currency available to them to Israeli currency and this according to the official exchange rates that shall exist in Israel at the time of execution of the aforementioned conversion in practice by each of them.

The term "exchange rate" means:

- a) As regards a time when there is a restriction pursuant to Israeli law on the free use of foreign currency in Israel - the highest sum in Israeli currency that an Israeli resident is required to pay for a unit of currency for such a debt with one who is authorized by law to trade in Israel in foreign currency together with a bank commission for such a transaction.
- b) As regards a time when there is no restriction as aforementioned - the highest purchase rate of a unit of currency of such a debt that shall exist in the Bank of Israel as regards bank telegraph withdrawals for a town known at that time as one of the financial centres of the country in which the currency of the debt is legal tender or in New York at the choice of the bank together with bank commission for such a transaction.

14. Without harming other instructions in the matter of consignment for immediate defrayal agreed with the company, the bank shall be permitted in each of the cases detailed hereinafter to consign for immediate defrayal the secured sums or any part of them without any prior notice to the company and these are the cases:

- a) If the company shall not defray to the bank on time or on the defrayal dates any sum that shall be due from the secured sums.
- b) If a resolution shall be taken for voluntary liquidation either by the company or if a liquidation order shall be issued against it by the court or if the company shall convene a creditors' meeting for the purpose of coming to an arrangement with them, or if the company's name shall be stricken or is about to be stricken from any register whatsoever conducted pursuant to any law.



- c) If a receiver shall be appointed (temporary or permanent) or a receiver and administrator (temporary or permanent) or a liquidator (temporary or permanent) for the company's property or any part of it.
- d) If any confiscation whatsoever shall be imposed on the company's property, in entirety or in part, or on any of the securities that were transferred by the company to the bank, or if an action shall be made by the court execution office against it.
- e) If the company shall cease paying its debts or managing its businesses.
- f) If work shall be terminated, or any part of it, for two months or more.
- g) If a significant part of the company's property shall burn or shall be damaged in any other way.
- h) If the bank shall see, at its absolute discretion, that there has been a change of the control of the company - as compared to the *status quo* on the date of signature on this bond - by voluntary transfer of shares or by another means (apart from transfers in good faith to the transferee who also was a company shareholder on the date of this bond, apart from transfer of shares by way of inheritance), or by a resolution of members constituting the company, without approval in writing and in advance from the bank.

- i) If an order for receipt of assets or a bankruptcy order shall be given against one of the company's guarantors (in the event that the secured sums are secured *inter alia* pursuant to letters of guarantee) or in the event of the death of a guarantor or in the event of appointment of a guardian for the body and the property of a guarantor, and the company shall not present to the bank within seven days from the date of the occurrence of one or more of the aforementioned events a letter of guarantee and undertaking signed by an individual or an entity which the bank shall agree to in advance and in the wording to be determined by the bank, according to which that same individual or entity shall guarantee vis-à-vis the bank for the full and accurate payment of all the above-mentioned sums. The provisions of this sub-section shall be imposed with the appropriate changes accordingly, also on that same individual or entity as if that same individual or entity were the original guarantor and on anyone who shall come in their stead.
- j) If the number of company shareholders and/or the number of members constituting the company shall be reduced to less than the minimum required.
- k) If the bank shall see, at its sole discretion, that a fundamental incident has occurred which could harm the company's financial ability.
- l) If at the absolute discretion of the bank and pursuant to its sole estimation there has been a detrimental change to the value of the securities given to secure defrayal of the secured sums.

- m) If the company shall be required to defray early defrayal of debts that the company owes to other creditors.
- n) If the company shall breach or shall not comply with any of its undertakings incorporated in this bond and/or pursuant to any agreement and/or any writing and/or engagement that was made in the past and/or that shall be made in the future between the company and the bank.
- o) If it shall transpire that any declarations by the company in this bond and/or in any writ of association which were made in the past and/or shall be made in the future between the company and the bank - is incorrect and/or is inaccurate.
- p) If the company changed its Articles of Association or part of it and did not inform the bank of this within 48 hours.
- q) If the company made a resolution regarding a merger with another company, whether as a receiving company or as a target company, as defined in the Companies Law 5759-1999, or a request for merger has been submitted or a request for an arrangement and reorganization the result of which shall be a merger of the companies.

r) If a license, certification, approval or registration of any of the intellectual rights of the company shall be revoked, cancelled, stayed or shall be harmed in any fundamental way, and the result shall have a fundamental effect on the company.

15.

..  
a) In each of the events detailed in the previous section, the bank shall be permitted to use any means that it shall see fit in order to collect all the secured sums, to realize the securities in any way that the law permits and to realize all its rights pursuant to this bond, including realization of the attached property, in entirety or in part, and to use their proceeds to defray the secured sums and this without the bank being required to realize other guarantees or securities if there shall be such with the bank.

b) The bank is permitted to realize the securities given to it pursuant to this bond or another, to appoint a receiver or a receiver and administrator on behalf of the bank (and the company agrees in advance to any individual or legal entity that the bank shall appoint or shall recommend to appoint as a receiver or administrator as abovementioned) and whereby amongst his other authorities it shall be permitted:

(1) To take into his possession the attached property, in entirety or in part.

(2) To manage the company's business or to participate in their management as it shall see fit.

- (3) To sell or to lease and/or to agree to sell or to lease the attached property in entirety or in part or to transfer it by any other method pursuant to the conditions that it shall see fit.
  - (4) To make any other arrangement as regards the attached property in entirety or in part.
16. All the revenues that shall be received by the receiver and the administrator from the attached property as well any consideration that shall be received by the bank and/or by the receiver and the administrator from the sale of the attached property or part of it, shall be credited:
- a) Firstly for defrayal of all the expenses that shall be caused as regards collection of the secured sums including the expenses of the receiver or the receiver and administrator and his salary at a rate that shall be determined by the bank.
  - b) Secondly for defrayal of additional sums that shall be due to the bank due to the terms of linkage, interest, damage fees, commissions and expenses due and that shall be due to the bank pursuant to this bond.
  - c) Thirdly for defrayal of the capital of the secured sums or any other accrediting arrangement that shall be determined by the bank.
17. In the event that during the realization of the attached property the date of defrayal of the secured sums has still not arrived or that the secured sums shall be due to the bank conditionally, the bank shall be permitted to collect from the realization proceeds a sufficient sum to cover the secured sums and the sum that shall be collected shall be attached to the bank for their security and shall remain in the bank until their defrayal.

18. Without derogating from the other provisions of this bond, any waiver, extension, discount, silence, abstention from action (hereinafter: “waiver”) on the part of the bank as regards partial non-compliance or incorrect compliance of any undertaking whatsoever of the undertakings pursuant to this bond, shall not be considered as a waiver on the part of the bank to any right whatsoever but rather as a limited agreement for the special circumstance in which it was given.

Any waiver that the bank shall grant to any party to a note that the bank shall hold pursuant to this bond, shall not influence in any shape or form the company’s undertakings.

19. ..
- a) If and in the event that the company shall be a guarantor (hereinafter: “the guarantor company”) the company hereby agrees that the bank shall be permitted:
- (1) To take any actions pursuant to law for the purpose of realizing the securities and/or for the purpose of collecting the aforementioned sums without the bank being required firstly to approach the guaranteed obligants with a request to defray the aforementioned sums due from them to the bank.
  - (2) To stop, change, increase, decrease or renew any credit or other banking service that has been given and/or shall be given to the obligants.

- (3) To give a time extension and/or similar discount in regard to defrayal of the aforementioned sums.
- (4) To exchange, renew, release, repair, abstain from compliance or to realize other securities or guarantees that the bank holds or shall hold whether it has received them or shall receive them from the obligants - the guarantors or from others.
- (5) To compromise with the guaranteed obligants or with others.

The guarantor company hereby agrees that any action taken whatsoever of the aforementioned actions by the bank shall not award them any right to change or cancel their undertakings vis-à-vis the bank.

b) Deleted.

20. The company confirms that the bank's books and accounts are acceptable to it, shall be considered to be correct and shall serve as evidence *prima facie* against it for all their particulars and *inter alia* in all matters relating to calculation of the secured sums, for the details of the notes and the guarantees and the other securities, and in any other matter relating to this bond.

The term “the bank’s books” means - any account sheet or a copy of an account sheet and any loan contract or note signed by the company, and the term “its accounts” means - any record or copy of a record whether registered or copied in handwriting or by a type writer and whether it was registered or copied by printing, duplication, photocopy or by means of any technical electrical or electronic device including microfilm.

21. The bank is permitted at any time, at its discretion, without requiring the company’s consent, to transfer this bond and its rights pursuant to it to another, including the securities, in entirety or in part, and any transferee shall be permitted also to transfer the aforementioned rights without requiring additional consent from the company. The transfer can be made by endorsement in the margins of this bond or by collection or in any other way that the bank shall see fit on condition that this shall not increase and/or change the company’s undertakings.
22. The bank is permitted to deposit the securities given to it or that shall be given to it pursuant to this bond or any part of them in the hands of a custodian at its discretion on account of the company and to replace the custodian from time to time, and the bank shall be permitted to safeguard the aforementioned securities, in entirety or in part, with any authorized authority pursuant to any law.
23. ..
  - a) Nothing in provision of this bond shall derogate from the bank’s right to collect the secured sums other than by realization of this bond.
  - b) Nothing in realization of this bond shall derogate from the bank’s right to collect from the company the balance of the secured sums which were not defrayed by realization of this bond.



24. All the expenses and fees relating to this bond, its stamp duty, its registration, realization of the securities (including the bank's attorneys fees) as well as insurance, safeguarding, possession and repair of the attached property shall be paid by the company to the bank at its first request, if expended by the bank or its representative including the receiver, together with interest at the maximum rate that shall be customary in the bank at that time for overdrafts and arrears in a current loan account, from the date of the request and until their full defrayal. Until their full defrayal all the aforementioned expenses shall be secured by this bond.
25. In this bond:
- a) "Bank" - means Bank Mizrahi Tefahot Ltd and each of its branches existing on the date of this bond and/or that shall open in any location whatsoever in the future, and those coming by the power of the bank and in its stead.
  - b) "Notes" - means promissory notes, bills of exchange, cheques, undertakings, guarantees, securities, bills of lading, deposit notes and any other negotiable documents.
  - c) The preface to this bond constitutes an integral part of it thereof.
  - d) If this bond is signed by two or more, the signatories shall be responsible, together and specifically, for compliance with all the undertakings pursuant to this bond.

26. Any notice that shall be sent by post by the bank to the company by registered letter or regular to the address noted above which the company shall inform the bank in writing, shall be considered to be a lawful notice that was received by the company within 48 hours of the time that the letter including the notice was sent.
27. The jurisdiction for the purpose of this bond is hereby determined as the authorized court in Tel Aviv, however the bank is permitted to use any legal means and also any other authorized court.
28. Special terms: [crossed out]

**And in witness the company hereby puts its hand**

**Stamp: Audiocodes Ltd**

(signature)\_\_\_\_\_ (signature)

The Company

**Appendix A**

The lien shall be imposed also on all the rights, including the intellectual property rights, of the company that exist at present and shall exist in the future whether they are registered in the name of the company or not, including if a request for their registration has been submitted and:

- (a) All the knowhow, inventions, patents, trademarks, designs, models, trade names, copyrights and technological processes and applications.
- (b) Domain names on the internet, licenses, franchise agreements, rights of use agreements, technical drawings, computer programs, trade secrets and customer data base.

And all this whether the company's rights have been registered in its name or not and whether the aforementioned rights exist at present or shall exist in the future.

As regards the aforementioned intellectual property rights or any part of them the company undertakes to ensure that it itself and any subsidiary:

- (a) Shall execute all the appropriate registrations and shall pay all the expenses and fees required in order to safeguard and protect all the intellectual property rights of the company and/or its subsidiaries and/or their registration.

- (b) Shall take all the steps required, including legal proceedings, to prevent any third party from harming those same intellectual rights.
- (c) They shall not sell, transfer, lease or give a license for use apart from licensing arrangements with a third party that is not an affiliated party which were made during the normal course of business and for the customary remuneration.

Date: December 12<sup>th</sup> 2011

Att:  
Bank Mizrahi Tefahot Ltd

Re: **Letter of Undertaking**

We the undersigned Audiocodes Ltd, Reg. No. 520044132 (hereinafter: "the company"), which administers an account with you hereby confirm and undertake as follows:

1. The company has been given or shall be given credit as defined in the agreement and terms of general business and/or the general terms for credit, all as agreed between the company and yourselves as regards any type of credit whatsoever (hereinafter: **"the credit"**).
  2. Whereas Adlersberg Shabati holds shares in the company and is a stakeholder in the company, the company and the stakeholder shall sign on this letter of undertaking.
  3. For as long as the credit has not been cleared in full, the company undertakes to you that:
    - 3.1. The company's equity capital shall not be less than \$40 million and its percentage as compared to the total balance sheet shall not be less than 25%.
-

Equity capital - as it appears in the company's financial reports (including *inter alia* the company's redeemed share capital, capital funds, undesignated profit balance less the cost of company shares held by it or by subsidiaries and plus/less any other clause included within the framework of the equity capital clause in the financial reports) plus deferred owners loans, less loans provided to affiliated parties less intangible assets as they shall appear in the company's financial reports.

- 3.2. The total of the company's financial undertakings including vis-à-vis banks, financial institutions, bond holders (inasmuch as there shall be such) shall not exceed \$36 million.
- 3.3. The operating profit (US GAAP) accrued for the last 4 quarters shall not be less than \$3 million. One-time expenses for deduction of intangible assets and/or expenses up to a total of \$3 million for an accounting record of the value of the bonus entailed in awarding options to employees pursuant to FAS 123 shall not be taken into account when calculating the operating profit.
- 3.4. The company's customers' debts plus cash and plus investments shall not be less at any time than \$50 million, whereby the sum in cash plus investments shall not be less at any time than \$30 million and the cash balance shall not be less at any time than \$15 million.

Cash - as it appears in the financial reports of the company including cash and cash equivalents, short-term deposits for a period of up to one year.

Investments - long-term deposits for a period of up to two years, negotiable bonds ranked A for a period of up to 3 years.

4. The financial ratios detailed in Section 3 above shall be examined pursuant to the company's audited annual reports (and quarterly reports approved by the company management and the board of directors).

We undertake that no later than June 30<sup>th</sup> of each year we shall transfer to you the company's financial reports as of December 31<sup>st</sup> of the previous year, when they are audited by an external CPA and prepared pursuant to the US GAAP rules of accounting, as they shall be from time to time.

We undertake that within 60 days from the end of each calendar quarter, we shall transfer to the bank a quarterly report including balance sheet, profit and loss report and cash flow report. Furthermore and without derogating for all the aforementioned, we hereby undertake to transfer to the bank from time to time at its request additional information in regard the businesses, the financial status and our bank credit.

5. The company hereby confirms that the credit that has been provided or shall be provided to it, *inter alia*, is based on its undertakings vis-à-vis the bank, as stated in this document, and that breach of any of its undertakings in this document shall award the bank the right to all the reliefs to which it is entitled pursuant to any law or agreement against the company, including the right to consign for immediate defrayal all the credit that the company received from the bank even prior to the agreed date of defrayal, and the right to enforce and to realize any security or guarantee that has been provided or shall be provided to the bank to secure the credit.

6. To avoid doubt it is hereby clarified that nothing stated in this document shall derogate or diminish in any way whatsoever any undertaking by the company vis-à-vis the bank pursuant to any other document that has been signed and/or shall be signed by the company, and the company's undertaking in this document shall be in addition to any other document that the company has signed and/or shall sign for the bank.
7. Our undertakings in this document are irrevocable and cannot be amended or cancelled without your consent in advance and in writing.
8. The financial criteria determined in Section 3 above of the letter of undertaking (hereinafter: "the criteria") are based on existing accounting standards and rules of accounting which have been implemented in the company's recent financial reports.

Implementation of different accounting standards and/or rules from those by which the recent financial reports were prepared, for the company's financial reports, including the International Financial Reporting Standards - IFRS), accounting standards in Israel and/or in the USA (hereinafter "new standards"), could cause changes that will have ramifications on the criteria.



Therefore the company agrees as follows:

At any time in which it shall become clear to the bank that the changes that have been caused and/or about to be caused to the company's financial reports, due to implementation of a new standard which necessitates such, it shall be permitted, after consultation with the company, to inform the company which changes are required by it to the criteria, in order to correlate them to the abovementioned changes, and this with the intention to correlate the original financial purpose according to the which the criteria were determined ("the amended criteria"). In the event that the bank shall inform the company after consultation with the company what the amended criteria are - they shall obligate the company starting from the date of transfer of the bank's notice.

9. Shabtai Adlersberg hereby undertakes that no change shall occur to his holdings of the company as such that it shall reduce his holdings under the rate of holding required pursuant to the Securities Law, 5728-1968 for the purpose of the definition of a stakeholder, without the consent of the bank in advance and in writing, and it is also hereby declared that any change that shall be imposed as aforementioned shall constitute a cause to consign the credit for immediate defrayal.
10. Loans which the company received and/or shall receive from a stakeholder in the company (hereinafter: "owners loans") shall be inferior and deferred from the company's obligations and undertakings to the bank for the provision of the loans, and the company's debts and undertakings vis-à-vis the bank for provision of the loans shall have priority as compared to the owners loans as they shall be from time to time. To avoid doubt it is hereby clarified that the services that the stakeholder provides and/or shall provide to the company as a "functionary" of the company, including as the chairman of the board of directors, president and/or company CEO, shall not be considered owners loans, and the company's debts and undertakings vis-à-vis the bank shall not have priority as compared to these services.

11. The company undertakes not to pay management fees, dividends, interest payments and/or any other payment to shareholders, and shall not defray owners loans or part of them until all the sums due from it to the bank for provision of the credit shall not be defrayed in full and for as long as the company's debts and undertakings to the bank shall not be defrayed in full for provision of the credit.

Notwithstanding the above-mentioned in this section, the company shall be permitted at any time to take any permitted action, as defined hereinafter, subject to at any time and even after execution of any permitted action, the company shall comply with all its undertakings as detailed in Section 3 above.

**Permitted action**

- (1) Permitted distribution, as defined in the Companies Law, 5759-1999 (including by way of purchase of company shares, for an accumulated sum that shall not exceed a total of \$25 million).
- (2) Payments to a stakeholder for services that the stakeholder provides and/or shall provide to the company as a "functionary" of the company, including as the chairman of the board of directors, president and/or company CEO.

12. We hereby undertake not to sell and/or transfer and/or render and/or lease and/or rent (hereinafter, jointly and severally - transfer) any assets whatsoever (including monies), in any shape or form, as they are at present and as they shall be in the future, in entirety or in part, from our ownership and/or from our possession during an entire consecutive period of 12 months, whereby the value of the assets is higher than 1 million US dollars (or equivalent in foreign currency and/or in NIS), that is not during the regular course of business and in favour of full remuneration to third parties (including to any of our shareholders directly or indirectly), without the consent of the bank in writing and in advance.
13. We hereby undertake that we shall not execute purchases/investments of any type whatsoever of/in companies and/or of/in assets and in any way whatsoever, whether indirectly or directly, whereby the sum of the purchase/investment exceeds 10 million US dollars (or the equivalent in foreign currency and/or in NIS, pursuant to the type of investment) during a consecutive period of each 12 months, without notice to the bank in writing and in advance. A notice to the bank shall not be given prior to a notice to the public if such is required.
14. This agreement replaces and comes in the stead of “the letter of undertaking” dated July 14<sup>th</sup> 2008.

Stamp: Audiocodes Ltd  
Public Co. 520044132  
(signature) (signature)  
Company signature

I agree to the aforementioned in Sections 9, 10 and 11 of this letter of undertaking.

(signature)

Signature Shabtai Adlersberg

Attorney's Confirmation:

I the undersigned Itamar Rosen of 1 Hayarden Street, Airport City hereby confirm that Audiocodes Ltd, Reg. No. 520044132 (hereinafter: "the company") made a lawful resolution to sign on this letter of undertaking in favour of Bank Mizrahi Tefahot Ltd and that the signature of Messrs Shabtai Adlersberg and Guy Avidan together with the company stamp or alongside its printed name obligates it pursuant to this document. Furthermore, I confirm that this document was signed before me by the aforementioned gentlemen.

Stamp:           Itamar Rosen, Adv  
                      No. 24634  
                      (signature)  
                      Signature

**Bank Mizrahi Tefahot Ltd**

**Deed of Pledge of Rights  
(of monies in an account/deposit account and rights in relation to a deposit)**

**Signed on the 12<sup>th</sup> of the month of December year 2001  
In the name of Audiocodes Ltd Identity Number/Corporation Number 520044132**

**Address**

**(hereinafter: “the pledgers”)**

Pursuant to the incorporation documents of the pledgers and the rest of the provisions that provide the pledgers with power in this matter and pursuant to the resolution of the directors (in the event that the pledgers are a company, a cooperative society, a foundation)

**In favour of - Bank Mizrahi Tefahot Ltd (hereinafter: “the bank”).**

Whereas it has been agreed between the pledgers and the bank, that the pledgers shall guarantee the bank defrayal of all the sums that the pledgers owe or shall owe to the bank, *inter alia*, in regard to provision of credit and/or the abovementioned banking services, by pledge of certain rights of the pledgers, and this in addition to any sum due or that shall be due to the bank, and is guaranteed by a lien or another security

**Therefore this deed of pledge testifies to the following:**

---

1. **In this deed of pledge:**

- a. **“The credit”** - whether in Israeli currency or any foreign currency whatsoever, whether in Israel or overseas including any revolving credit, temporary credit, one-time credit, loan, discount of bills, purchase of bills, brokerage of bills, overdraft, provision of guarantee and/or letter of indemnification, opening documentary credit, provision of various banking extensions and easements, handling of bills of lading, transactions with securities, various transactions with financial instruments and/or derivatives, service or other payment, which have been provided or shall be provided by the bank to the pledgers or to their order as well as any transaction or other action according to which or following which debts and undertakings have been created or could be created by the pledgers vis-à-vis the bank, whether as an obligant or as a guarantor and whether as an endorser and/or in another fashion, whether severally or jointly with others, whether due or shall be due, whether consigned for defrayal before signature on this deed of pledge or consigned for defrayal afterwards, whether due specifically or conditionally, whether directly or indirectly, whether explicitly or whether in general.
- b. **“Other banking service”** - this means each of the following transactions made on behalf of the bank at the request of the pledgers: provision of letter of indemnification and any guarantees whatsoever for the pledgers or for others at the request of the pledgers (including guarantees in any form whatsoever), opening documentary credit, handling of bills of lading or securities, provision of extensions, various banking easements and any other transaction.

- c. **The plural includes the singular and vice versa:** If this deed of pledge has been signed by two pledgers or more, its terms shall obligate all the signatories jointly and severally. Any mention in this deed of pledge of the pledgers whether in regard to their undertakings or in any matter, shall be considered to refer to all the pledgers jointly and severally or to several of them. Provision of any banking service by the bank to each of the individuals constituting the pledgers, shall be considered as if it was received by each of the individuals of the pledgers.
- d. **“The pledgers”** - referral to them shall be interpreted as including and referring to each individual of the pledgers or any of them, including their heirs, the executors of their wills and the executors of their estates and anyone representing them or coming in their stead and the receiver of their assets, liquidators and trustees. The undertaking of all the individuals of the pledgers shall be jointly and separately. If the pledgers are a corporation - included in this term are also partners, shareholders, directors, liquidators and anyone coming in their stead.
- e. **“The bank”** - the meaning is Bank Mizrahi Tefahot Ltd and each of its branches existing on the date of signature on this deed of pledge and/or that shall be opened in the future, and all those representing the bank. Furthermore it includes subsidiaries of the bank, and companies affiliated with the bank, whereby at least 20% of their redeemed capital or by virtue of voting in them, is in the possession of the bank and/or the shareholders who have control of the bank.

f. **“Bills”** - means promissory notes, cheques, exchange notes, undertakings, guarantees, securities, drafts, bills of lading and any other negotiable documents.

g. The preface to this deed of pledge constitutes an integral part of it thereof.

2. ..

a. This deed of pledge is given to guarantee full and accurate payment of all the sums due and/or shall be due to the bank from the pledgers, *inter alia* in regard to provision of the aforementioned credit and/or the banking services that the pledgers received from the bank, whether due from the pledgers alone, or together with others, whether due from them personally or due from them as a corporation, or according to the name of the business which they manage, or are owners of or according to any other name whether due from the pledgers pursuant to the current composition or pursuant to any other composition whatsoever, according to the name of their business or according to any other name, whether the pledgers have already obligated to them or shall obligate to them in the future, whether due from them as an obligant or a guarantor, or an endorser, whether due specifically or conditionally, whether due directly or indirectly.

c (signature) \_\_\_\_ **“b. The inclusive sum that we shall be obligated to pay to the bank pursuant to this deed of pledge of rights is unlimited in sum (hereinafter: “the sum of the deed”).**



All the expenses and charges in relation to the preparation of this deed of pledge of rights and its registration with the appropriate Registrar, expenses entailed in the expense of executing and exercising this deed of pledge of rights, attorney's fees (pursuant to the instructions of the Bank of Israel), other legal expenses, shall be imposed on the pledgers, subject to the instructions of the Bank of Israel as they shall be from time to time, and shall be added to the sum of the deed, as defined above, including all its sub-sections, together with interest for delay as detailed in the "Credit for a private/business customer" booklet or at a rate that shall be agreed to in an agreement for provision of banking services from the date of the request until full defrayal or as it shall be determined by the authorized judicial authority.

Until full defrayal all the aforementioned expenses and charges shall also be guaranteed by this deed of pledge of rights.

**(All the aforementioned sums guaranteed by this deed of pledge of rights shall be called hereinafter: "the abovementioned sums").**

3. The pledgers hereby undertake to pay the bank any sum of the abovementioned sums.
  - a. On the agreed date of defrayal, if agreed or shall be agreed between the pledgers and the bank for that same sum that shall be consigned for defrayal on a certain date, or on request, or on the occurrence of a certain event, or at a certain time after the request or after the occurrence of a certain event.

- b. At the end of three days from the date of sending the bank's first written request to the pledgers, if a date for the aforementioned defrayal has not been agreed in Paragraph a above.
4. Unless permitted explicitly in a specific credit agreement or in the "Credit to a private/business customer" booklet, the pledgers shall not be permitted to defray any sum of the aforementioned sums before the agreed date for its defrayal, in the event that it has been agreed or shall be agreed between the pledgers and the bank the date for its defrayal, without the bank's consent in advance and in writing. Taking into account the aforementioned, the pledgers hereby agree that the provisions of Section 13(b) of the Pledge Law 5727-1967, shall not apply.
5. The bank is permitted to calculate interest on the aforementioned sums at a rate that shall be agreed upon from time to time between the bank and the pledgers, and in cases when no rate of interest has been agreed, the bank is permitted to determine itself the rate of interest by providing a notice to the pledgers. The bank shall be permitted to add the interest to the capital at the end of each quarter year or at the end of any other period. In any event of awarding the bank the right to realize the securities pursuant to this deed of pledge, the bank shall be permitted to raise the rate of interest agreed for it and/or determined as aforementioned, up to the rate of interest in arrears as detailed in the "Credit for a private/business customer" booklet or at a rate agreed upon in an agreement for provision of banking services and this from the date of the event and until full defrayal.

6. As a security and as a guarantee for full and accurate defrayal of all the aforementioned sums (and by virtue of Articles 165 and 166 of the Companies Law (New Version) 5743-1983 in the event that the pledgers are a company) and by virtue of the Pledge Law 5727-1967 and any other law existing at that time in Israel which validates such a lien, the pledgers hereby pledge in favour of the bank and/or to its order **as a pledge and first degree fixed lien and assignment by way of the lien all the pledgers' rights in Account No. ##### in Branch 418 (hereinafter: "the account") including all the pledgers' rights to monies and/or deposits and/or deposited assets and/or that shall be deposited and/or that shall be found in the account including securities of any form whatsoever that shall be in the account and the revenues, interest and the remunerations that the company shall have for and in relation to the account (hereinafter: "the pledged rights").**
7. The pledgers hereby declare that the pledged rights are not attached, pledged or confiscated in favour of any other, and that there is no restriction or condition imposed pursuant to law or agreement for transfer of ownership of the pledged rights or of the pledge to the bank.
8. The pledgers hereby undertake:
  - a. That the bank shall be entitled to delay payment of monies or monies in deposits incorporated in the pledged rights until defrayal of all the aforementioned sums. The pledgers shall not be entitled to withdraw the aforementioned monies or to take action with them or in regard to them in any way whatsoever, without the consent of the bank in writing and in advance.

- b. That the liability of the bank to pay the monies from the deposits incorporated in the pledged rights ceased being a liability that is customary in the bank vis-à-vis a customer and it becomes a conditional liability, *inter alia*, as a prerequisite that the abovementioned sums shall be defrayed to the bank in full before the bank shall be obligated for any payment whatsoever on account of the monies in deposits.
- c. For as long as this document shall be in force, the pledgers undertake irrevocably to give the bank - in advance and from time to time - instructions in writing for renewal for the deposit and the monies of the deposit. The pledgers agree that in any event for any reason whatsoever the pledgers shall not give a renewal instruction as aforementioned or contrary to their previous renewal instruction they shall give a withdrawal instruction for the monies of the deposits or in part on the date of their defrayal; then the bank shall be permitted to deposit from time to time the monies of the deposit as regards the deposit bearing interest (in shekels or the currency of the deposit, accordingly) for a period similar to the period that ended on the eve of the renewal and on the interest and/or linkage terms that shall be customary in the bank at that time as regards deposits of the same type and the same sum, or at the choice of the bank for a shorter period than shall be customary at that time in the bank in regard to deposits of its customers in shekels or in the currency of the deposit, accordingly. The pledgers are aware that in any event that the bank shall renew the monies of the deposit by virtue of this section, the pledgers shall have information as regards the rates of interest and/or the terms of linkage of the monies of the deposit renewed in the bank branch in which the deposit is administered.

- d. Not to sell and/or transfer and/or convey and/or assign in any other way the pledgers' rights or part of them in any shape or form whatsoever to any other entity without the consent of the bank in writing and in advance.
  - e. To immediately inform the bank of any incident of lien of the pledged rights or any part of them and to inform immediately to the imposer of the lien about the pledge in favour of the bank, and to take on their account immediately all the means required to remove the lien.
  - f. Not to pledge or attach the pledged rights, in entirety or in part, in any way whatsoever, with prior, equal or later rights than the rights provided to the bank pursuant to this deed of pledge, without the consent of the bank in writing and in advance.
9. In order to guarantee the bank's rights pursuant to this deed of pledge, vis-à-vis the pledgers' creditors, extant or future, the pledgers hereby agree that the pledge hereby created in favour of the bank, shall be registered with the Registrar of Companies, pursuant to the Companies Ordinance, and/or at the appropriate Office of the Registrar of Pledges, and for the purpose of the aforementioned registration the pledgers hereby undertake to sign on a notice of pledge as well as on any other document required pursuant to law and any other document that the bank shall determine to be necessary in its judgement, in regard to this deed of pledge and its registration. All the expenses entailed in preparation of this deed, and its registration, shall be paid by the pledgers to the bank at its first request, and until their full defrayal all the aforementioned expenses shall be guaranteed by this deed of pledge (including interest for delay from the date of request and until defrayal in practice).

10. The securities given to the bank pursuant to this deed of pledge shall be independent of any other security that the bank has received or shall receive from the pledgers or for them, and shall serve as revolving securities notwithstanding any arrangement for the accounts or for any of the pledgers (shall serve as revolving securities for all the other sums that the pledgers shall owe to the bank in all its branches). If the bank shall compromise or give an extension or an easement to the pledgers, the bank shall change the pledgers' undertakings in regard to the aforementioned sums, shall release or waive any other securities or guarantees, these shall not change the nature of the securities created by the deed of pledge, and all the pledgers' securities and the undertakings pursuant to this deed of pledge shall remain in full force.

11. **The bank's rights**

11.1 In this section:

“Asset” - in any shape or form, including monies, in Israeli currency or foreign currency, securities and rights including monies that the State or any other entity transferred or shall transfer to the bank in any form whatsoever for the pledgers as well as including the aforementioned asset that has been transferred and/or will be transferred by the pledgers or for them to the bank for collection and/or for security and/or for custody and/or in any other method, including the remuneration of those assets.

11.2 The bank shall have the right to place a lien on any assets that are due and/or shall be due to the pledgers from the bank in any form whatsoever and from any source whatsoever and in any account whatsoever, whether the account is registered in the name of the pledgers alone or in the name of the pledgers together with others, as well as assets that are located and/or shall be located with the bank for the pledgers at any time whatsoever, and the bank shall be permitted at any time that is required in the bank's opinion to protect its rights, from experience, inasmuch as it is reasonable in the circumstances of the matter, to inform of this in advance to the pledgers, to stay the aforementioned asset until defrayal of all the sums of monies due or that shall be due to the bank from the pledgers and have still not been defrayed from the aforementioned sums.

Inasmuch as these are sums for which the date of defrayal has still not arrived, the bank shall be permitted to use its right pursuant to this section as aforementioned only if there is a reasonable concern that the pledgers shall not comply with their undertakings to the bank.

- 11.3 The bank shall have the right to prevent the pledgers from withdrawing credit balances at their disposal in any account whatsoever whether the account is registered in the name of the pledgers alone or on the name of the pledgers together with others, and the credit balances are located and/or shall be located with the bank for the pledgers at any time whatsoever, at any time that the pledgers owe monies to the bank and the bank is of the opinion that the withdrawal of the aforementioned credit balances could harm the bank's rights.
- 11.4 Without derogating from the aforementioned, the bank shall be permitted to set off at any time any credit balance of the pledgers (as detailed in Section 13.3 above) against the aforementioned sums and the credit balance shall serve for defrayal of the aforementioned sums. The bank shall attempt, inasmuch as it shall be reasonable in the circumstances of the matter, to inform the pledgers of this in advance. For the purpose of execution of the aforementioned the bank shall be permitted to take any legal steps or others, as the bank shall see fit in the circumstances of the matter.

Furthermore, the bank shall be permitted to set off the pledgers' deposits whereby the date of their defrayal has still not arrived and this against the aforementioned sums for which the date of defrayal has arrived, including due to consignment for immediate defrayal or due to an anticipated breach by the pledgers.

The pledgers are aware that in such a case changes detrimental to the pledgers could be imposed in all matters relating to their rights for that same deposit such as loss of interest and loss of right to grants and the pledgers shall not have any claim against the bank in this matter.



12. The bank shall be permitted at any time to charge any account whatsoever of the pledgers with them for any sum due or shall be due to it from the pledgers, and to credit any sum whatsoever that it received from the pledgers or for them to the credit of that same account that it shall see fit. To transfer any sum in favour of the pledgers in any account whatsoever with it, to any other account that it shall see fit, as it shall see fit. For sums in foreign currency credited to the pledgers the bank shall be able to sell at any time and to collect additions and donations paid to the pledgers incidental to the sale of foreign currency.
13. ..
  - a. On the occurrence of one of the events awarding the bank the right for consignment of immediate defrayal of the aforementioned sums, pursuant to any document that has been signed or shall be signed by the pledgers, the bank shall be permitted to use any means that it shall see fit, in order to collect the aforementioned sums from the pledgers and to realize the securities in any way that the law shall permit and to realize all its rights pursuant to this deed of pledge including by way of realization of the aforementioned sums and this without the bank being required to realize other guarantees or securities if the bank shall have such.

- b. Further to that stated in sub-section a above, the pledgers shall pay the bank an agreed and estimated compensation in advance for any failure, damage or loss that shall be caused to the bank as a result of consignment for immediate defrayal - a sum equal to the total of all the sums that the bank customarily collects as commission for early defrayal as shall be customary from time to time in the bank, or a sum that the bank shall be permitted to collect as early defrayal commission pursuant to law and/or pursuant to the instructions of the Bank of Israel - the higher of the two.
- c. In the event that it shall not be determined otherwise by a court order or an order of the Head of the Court Executions Office, all the sums shall be collected by the bank from realization of this deed of pledge shall be used for:
- (1) For defrayal of the expenses caused as a result of the realization of this deed of pledge.
  - (2) For defrayal of the rest of the expenses, bank charges and the interest due to the bank including additional sums due to linkage of the interest.
  - (3) For defrayal of the sums of the capital that shall be due to the bank, including additional sums due to linkage of the capital.
- d. Nothing in the provision of this pledge shall derogate from the right of the bank to collect the aforementioned sums other than realization of its rights pursuant to this deed of pledge; nothing in the realization of the bank's rights pursuant to this deed of pledge shall derogate from the bank's right to collect from the pledgers the balance not defrayed for realization of its rights pursuant to this deed of pledge.

- e. Nothing in provision of this pledge shall derogate or harm the bank's rights and/or the pledgers' undertakings pursuant to other documents on which the pledgers have signed and/or shall sign.
14. The pledgers hereby declare that the bank's books and its accounts shall be acceptable to them and shall be considered to be admissible proof in all matters relating to the rates of the aforementioned sums.
  15. If this deed of pledge shall be signed by a limited liability company, or by a cooperative society, then the pledge created pursuant to it shall be considered as if it was made pursuant to the Pledge Law 5727-1967 and pursuant to the Companies Ordinance (New Version) 5743-1983 and/or the Companies Law 5759-1999 or pursuant to the Cooperative Societies Ordinance from 1933 according to the event.
  16. The waiver of the bank to the pledgers as regards a previous breach, or previous non-compliance with one or more of their undertakings pursuant to this deed of pledge, shall not be considered as justification or as a pretext for an additional breach or additional non-compliance of any term or undertaking of this deed of pledge.
  17. The address of pledgers is as written above or any other address in Israel of which they shall inform the bank in a recorded letter whereby the bank shall confirm its receipt in writing. Any notice that shall be sent to the pledgers by the bank by regular post according to the aforementioned address shall be considered as if it was received by the pledgers in a timely fashion pursuant to the regular post arrangements. A declaration by the bank in regard to sending a notice and the time it was sent shall serve as admissible proof against the pledgers as regards the time and the delivery noted therein.

18. The parties hereby waive the need to send a notarized warning in all matters relating to this deed.
19. The jurisdiction for this purpose has been determined as the authorized court in Israel.
20. The bank shall be permitted at any time, without needing the additional consent of the pledgers, to transfer this deed to another, and the rights pursuant to this deed including the guaranteed sums, without needing the additional consent of the pledgers.
21. Special terms:

**In witness the pledgers hereby put their hands:**

c

c

Stamp:

Audiocodes Ltd  
Public Co. 520044133  
(signature) (signature)  
**Signature of the pledgers**

## Mizrahi Tefahot

Date: July 23<sup>rd</sup> 2012

Att: AudioCodes Ltd (hereinafter: "the company")

Dear Sir or Madam,

**Re: Letter of Undertaking dated December 12<sup>th</sup> 2011**

Whereas on December 12<sup>th</sup> 2011 you signed on a letter of undertaking for us (hereinafter: "the letter of undertaking");

And whereas in Section 3.3 of the letter of undertaking it was determined that the operating profit (as defined in that section) accrued for the last 4 quarters shall not be less than a total of \$3 million (hereinafter: "the aforementioned financial index ", "the abovementioned cause");

At your request we confirm that we are suspending the exercise of our right to of immediate repayment of your debts and undertakings to us due to the aforementioned cause and this until publication of the reports of December 31<sup>st</sup> 2013 (hereinafter: "the suspension period"); on condition of compliance with all the following conditions:

---

1. The operating loss (Non GAAP) of the company for 2012 shall not exceed \$6 million.
2. The company shall have operating profit (Non GAAP) in the first quarter of 2013.
3. You shall pay the bank a one-time payment of \$15,000 and your account shall be debited with this sum.
4. The interest on the existing loans shall be increased from today and until full defrayal by 0.75% (annual).

This confirmation is limited to the aforementioned cause only and for the aforementioned period only and it shall not derogate from our right to consign your debts and undertakings for immediate defrayal, including during the suspension period, for any other cause.

To avoid all doubt it is clarified that our consent should not be seen as an amendment of the letter of undertaking and that all the terms of the letter of undertaking remain fully in force. It shall also be clarified that this consent shall not derogate from our rights to you pursuant to any document or pursuant to law.

This letter is subject to your compliance with your undertakings to maintain any financial indices vis-à-vis any entity that you have made undertakings to or alternatively that you have received a letter of waiver in the event that you are not complying with those same financial covenants or part of them.

That stated in this letter is conditional on your consent in the margins of this letter.

Yours sincerely,

Bank Mizrahi Tefahot Ltd  
Business Division - Corporations Sector  
(signature)  
Alon Egozi  
Corporations Sector Manager

(signature)  
Danny Maor  
Hi-tech Department Manager  
Commerce and Services

We agree to the aforementioned  
(signature)  
Audiocodes Ltd







**Request for receipt of credit in foreign currency**

No. of type                      Name of type  
 9035/9                              Loan, in foreign currency at variable interest - dollar only

Customer details                      Credit Account (customer number)                      Customer name  
   #### #####/###    AudioCodes Ltd

Account details	Type of account	Account for provision	Branch	Bank	Currency of account
	095	#####/###	978	10	0001/8 US dollars
	Type of account	Account for provision	Branch	Bank	Currency of account for defrayal
	095	#####/###	978	10	0001/8 US dollars
	Type of account	Account for provision	Branch	Bank	Currency of account for commissions
	095	#####/###	978	10	0001/8 US dollars
Credit details	Sum of credit				
	6,000,000.00		Six million only*****		
	Currency of credit				
	0001/8 US dollar				
	Term of credit			Date of provision of credit	Designation of credit
	60 months from the date of provision of the credit			September 28 <sup>th</sup> 2011	

Credit details	Variable credit	Interest margin	Accrued period	Term of interest for definition of Libor
	3.7750% per annum	3.4000% per annum above "Libor" basis	### months	3 months
	Frequency of payment			
	03 - quarterly on the 28 <sup>th</sup> of each of the months December, March, June, September			
	Date of first payment		Date of last payment	
	December 28 <sup>th</sup> 2011		September 28 <sup>th</sup> 2016	
Defrayal of capital	Number of inclusive payments		Frequency of payments	
	20		03 - quarterly	
	On the 28 <sup>th</sup> of the months December, March, June, September			
	Total of each payment			
	From the 1 <sup>st</sup> payment and until payment of the 20 <sup>th</sup> 300,000.00 US dollars			



Date: December 12<sup>th</sup> 2011

Att:

Bank Leumi Le'Israel Ltd

Dear Sir or Madam,

**Whereas** Mr Shabtai Adlersberg holds shares of the undersigned, Audiocodes Ltd ("**the company**") and is a stakeholder in the company, as detailed in his report to the Securities Authority in the United States in February 2008, attached as an integral part of this document and as the term "stakeholder" is defined in the Securities Law 5728-1968 (hereinafter: "**the stakeholder**");

**And whereas** as one of the conditions of provision of credit, banking services and receipt of various undertakings and guarantees from the company, you have requested that the company and the stakeholder shall sign for you on this document and on the undertakings detailed hereinafter, and the company and the stakeholder have agreed to this:

Therefore we hereby declare and undertake as follows:

1. **Financial criteria**

We agree that the provision of credit and banking services to our company and/or with our guarantee and their continued administration shall be dependent on our company providing at any time all the following financial criteria:

---

Financial leverage (the capital structure):

- 1.1. The sum of the **tangible equity capital** of the company shall not be less at any time than a total of 40 million US dollars;
- 1.2. The sum of the **tangible equity capital** of the company shall not be less at any time than 25% of the company's total balance sheet;
- 1.3. The rest of the company's undertakings (short term and long term) vis-à-vis banks and other financial institutions, as they appear in the financial reports, shall not exceed at any time a total of 33 million US dollars;

Balance sheet structure

- 1.4. The balance of cash in the company shall not be less at any time than a total of 20 million US dollars;
  - 1.5. The balance of cash and investments of the company shall not be less at any time than a total of 30 million US dollars;
  - 1.6. The balance of cash, investments and customers of the company shall not be less at any time than a total of 50 million US dollars;
-

Profitability

1.7. **The operating profit** of the company accrued for 4 quarters shall not be less at any time than a total equal to 3 million US dollars.

To avoid doubt it is hereby clarified that within the framework of the calculation of the operating profit expenses for deduction of intangible assets and/or expenses up to a total of 3 million US dollars for accounting records of a value of the benefit entailed in awarding options to employees pursuant to FAS123 shall not be taken into account.

In this section the following terms shall have the following meanings:

**“Financial reports”** means - the company’s consolidated annual and quarterly reports published by it pursuant to the customary rules of accounting (US GAAP), including *inter alia* balance sheet report, profit and loss report, cash flow report, report on changes to equity capital and every other report or annotation that shall be required pursuant to accounting standards rules and/or by any of the authorized authorities.

**“Investments”** means - as defined and their value in the financial reports, including long term deposits up to two years, negotiable bonds ranked A and above for a period of up to three years.

**“Customers”, “total balance sheet”, “the operating profit”** means - as defined and their value in the financial reports.

---

**“Cash”** means - as defined and their value in the financial reports, including cash, cash equivalent and short term deposits for a period of up to one year.

**“Tangible equity capital”** means - equity capital as presented in the financial reports, including redeemed share capital, undivided surplus, funds, plus the balance of the sums of owners loans capital for collection which were signed vis-à-vis the bank by the company and the shareholders, writs of subordination less deferred expenses, intangible assets such as: goodwill, patents, trademarks, trade names, copyrights and so forth less obligants to the company who are stakeholders and/or subsidiaries and/or affiliated companies of the company (as these aforementioned terms are defined in the Securities Law 5728-1968) and less guarantees given by the company to guarantee the debts of the stakeholders and/or subsidiaries and/or affiliated companies of the company.

As regards financial reports prepared pursuant to IFRS the definition of the equity capital shall change according to that detailed hereinafter:

- a. Minority rights appearing within the framework of the equity capital (as regards consolidated reports) shall not be included.
  - b. The equity capital shall also include the warrants whereby the supplement for their realizations is linked (shall appear within the framework of the liabilities).
-

- c. The equity capital will also include the conversion component for bonds to be converted whereby the price of their realization is linked (in the event that they shall appear separately within the framework of the liabilities in the balance sheet).
- d. No re-evaluation fund shall be included for fixed assets which was created following implementation of the re-evaluation model during the period **after** consolidation of the financial stipulations.

In regards to the financial reports prepared according to US GAAP standards, the definition of the equity capital (for consolidated reports) shall not include the minority rights appearing within the framework of the equity capital.

The financial criteria determined in Sections 1.1-1.7 above (hereinafter: **“the financial criteria”**) are based on accounting standards, accounting rules, estimates and accounting policies (hereinafter: **“accounting administration”**) as they shall be implemented in the company’s last financial reports according to the US GAAP standards, as of the date of this document (hereinafter: **“the last reports”**), and the company declares that as of the date of signature on this document it is complying with the criteria.

An accounting administration different from the one on which the last financial reports are based pursuant to the US GAAP standards including, but not only, due to implementation of International Financial Reporting Standards (“IFRS”), new / other/ any accounting standards whatsoever in Israel or overseas, amendment of estimates and/or changes to accounting policies (all the aforementioned shall be called hereinafter, jointly and severally: **“new accounting administration”**) could cause changes that shall have ramifications on the criteria.

---



Therefore the company agrees as follows:

At any time that it shall become clear to the bank, at its absolute discretion, that changes have been caused and/or shall shortly be caused to the company's financial reports, due to a new accounting administration, it shall be permitted, after consulting with the company however without requiring their consent, to inform the company which changes are required by it to the financial criteria (hereinafter: **"the amended criteria"**), in order to correlate them with the aforementioned changes, and this with the intent to correlate them to the original economic purpose according to which the criteria were determined.

If the bank has informed the company as to the amended criteria - they shall obligate the company starting from the date of transfer of the bank's notice and this document shall be considered to include, starting from the date of the bank's notice, the amended criteria.

2. **Undertaking not to change stakeholder's holdings**

We undertake that there shall be no change to the percentage of the stakeholder's holding in the capital, shares and voting rights in the company as compared to the status on the date of signature on this document, as such that decreases his holdings to less than the percentage of the holdings required pursuant to the Securities Law 5728-1968, for the purpose of definition of a "stakeholder", without the consent of the bank in writing and in advance.

---

3. **Undertaking not to execute a merger**

We undertake not to execute, not to undertake to execute and not to take any actions whatsoever for execution of a merger or division with another/other corporation/s, without receiving the consent of the bank in writing and in advance. For this purpose we undertake to transfer to the bank immediately any information and document, required by the bank, at its discretion, for the purpose of determining its position as regards the merger.

The company's undertakings as aforementioned in this section are imposed as regards a merger pursuant to the eighth part or pursuant to ninth part of the Companies Law, 5759-1999 and as regards any action the result of which shall be acquisition of the majority of the company's assets by an individual or another corporation or any action that as a result of which company shares are purchased which award the buyer control of the company or any action as the result of which the company acquires, directly or indirectly, the majority of the assets of another corporation or shares of another corporation which award it control of that same corporation.

---

4. **Undertakings for non-execution of purchases and/or investments**

We undertake not to execute, not to undertake to execute and not to take any actions whatsoever to execute purchases and/or investments in any shape or form whatsoever of and/or corporations and/or assets and/or by any other method, whether directly or indirectly, for as long as the accumulated sum of the purchases and/or the investments as aforementioned during a period of 12 consecutive months exceeds a total of 10 million US dollars, without receiving the consent of the bank in writing and in advance.

5. **Undertaking for non-execution of dispositions for the company assets**

We hereby undertake that we shall not sell and/or transfer and/or deliver and/or lease and/or rent (hereinafter jointly: “**the transfer**”) any assets whatsoever (including monies), in any shape or form, as they are at present and as they shall be in the future, in entirety or in part, from our ownership and/or our possession during an entire consecutive period of 12 months, inasmuch as the value of the assets as aforementioned shall exceed 1 million US dollars, other than during the normal course of business and for full consideration to third parties (including if any of them are our shareholders directly or indirectly) without the consent of the bank in writing and in advance.

6. **Undertaking for liens at an equivalent degree and for non-provision of guarantees**

We hereby declare and undertake as follows:

- 6.1. Apart from that detailed in the Registrar of Companies as of the date of signature on this document, we have not created and have not undertaken to create any pledge and/or lien of any type whatsoever on any asset whatsoever of our assets and/or part of them, as they are at present and as they shall be in the future, in favour of any third party whatsoever.
-

- 6.2. Without derogating from the aforementioned in Section 6.1 above, we shall be permitted to create a current lien in favour of other banks as well as a first degree fixed lien on deposits of monies that shall be deposited from time to time in those same banks on condition of compliance with all the following terms:
- 6.2.1. Prior to creation of the abovementioned liens an interbank agreement shall be signed in wording to your satisfaction in regard to division of the remuneration from realizations of the liens;
  - 6.2.2. In the event that to guarantee our debts vis-à-vis any other bank whereby between it and yourselves an interbank agreement shall be signed as abovementioned in Section 6.2.1, we shall provide any security, create and register the security as abovementioned also in your favour.
- 6.3. If no guarantee and/or undertaking to provide a guarantee whatsoever shall be provided by us as aforementioned in favour of any third party whatsoever, apart from guarantees during the normal course of business and/or bank guarantees (against which we did not provide guarantees other than during the normal course of business and/or any other securities whatsoever).
-

7. **Undertaking to present financial reports**

We undertake to present to you the following reports:

- 7.1. The company's and the company's consolidated financial reports no later than June 30<sup>th</sup> of each year, including *inter alia*, balance sheet, profit and loss report, cash flow and any other report that shall be required by the authorized authorities (hereinafter: "**the financial reports**") annually, audited by an external CPA and relating to December 31<sup>st</sup> of the previous year.
  - 7.2. The company's consolidated quarterly financial reports up to no later than 75 days from the end of each quarter as they shall be reported to the Stock Exchange and relating to the end of the proximate quarter.
  - 7.3. Reports signed and approved by the company's VP Finance up to no later than 30 days from the end of each quarter, as regards inventory, receivables, company liabilities to the banking system, and the company creditors. The abovementioned reports shall also include *inter alia* the following particulars:
    - 7.3.1. **Inventory report** - a report on the inventory balances pursuant to the company's financial reports.
    - 7.3.2. **Receivables report** - including details of the receivables in Israel, receivables from overseas, cheques and notes for collection, down payments from customers (which are not against a bank guarantee) and details about aging of receivables and details of the names of the major customers.
-

7.3.3. **A report in regard to liabilities to the banking system and other secured creditors** (detailed pursuant to each of the banks and other creditors individually and separately) - including details in regards to short term credit (including Israel Land Administration), long term loans, documentary credit, company import, guarantees and total obligo.

7.3.4. **Balances and other debts report** - including details about debts to employees (for salaries, vacation, severance compensation and pensions), provisions for income tax at source for employees, debts to local authorities and debts to government institutions (such as: income tax, purchase tax, national insurance, property tax and so forth).

7.4. At the bank's request any report, document or additional information plus other clarifications inasmuch as they shall be required, including and without derogating from the generality of the aforementioned, a detailed business plan and the reports that the company shall transfer to its shareholders, and all in the manner and format that shall be required by the bank.

8. **Undertaking to present additional reports and reporting**

We undertake to present to you a copy of any confirmation, notice, report or any other document that we are required to transfer to the Registrar of Companies and/or the Securities Authority pursuant to any law, and this simultaneous to presenting them to the Registrar of Companies and/or the Securities Authority.

---

Without derogating from the generality of the aforementioned, we further undertake to inform you immediately of any prosecution or legal proceeding of any kind whatsoever which has been filed or which has been opened in the court, tribunal of any other judicial institution, including arbitration or quasi arbitration, in Israel or overseas, for a total of no less than one million US dollars.

9. **Undertaking not to issue securities to the bearer of this document**

We undertake not to issue securities to the bearer of this document, without the consent of the bank in writing and in advance.

We declare that as of the date of signature on this document no securities have been issued by the company to the bearer of this document.

10. **Undertakings vis-à-vis third parties**

- a. We undertake to inform the bank, at a reasonable time in advance and in writing, of our intention to make an undertaking vis-à-vis any third party whatsoever, including but not only, within the framework of issuance of shares, for undertakings that are or could restrict, in any way whatsoever, our right to create securities in favour of the bank which are required and/or could be required to guarantee credit and/or existing and/or anticipated banking services and to present to the bank in the wording of the undertaking as aforementioned before its final consolidation. We are aware that the undertaking vis-à-vis a third party as abovementioned could cause the cancellation and/or reduction of the credit lines before the end of their term and/or cancellation of the undertaking to provide credit and/or banking services, inasmuch as such have been provided and/or shall be provided, and we agree to this.
-

- b. We undertake to inform the bank, at a reasonable time in advance and in writing, of our intention to take upon ourselves, vis-à-vis any third party whatsoever, including but not only, within the framework of an issuance of shares, financial criteria the breach of which shall award or could award, to that same third party, a cause for consignment of our debts for immediate defrayal.
  - c. We undertake and declare that in the event that we have obligated vis-à-vis any third party whatsoever with an undertaking which shall have priority and/or harm and/or is contradictory with our undertakings pursuant to this document (hereinafter: **“the priority undertakings”**), the priority undertaking shall also be imposed in favour of the bank and we shall contact the bank immediately in order to amend our undertakings pursuant to this document thus that they shall not be subordinate as compared to the priority undertaking.
-



- d. If any event shall occur the result of which could award any entity whatsoever in Israel and/or overseas pursuant to any document whatsoever signed and/or that shall be signed by us in favour of early defrayal of our debts to it and/or consignment of our debts for immediate defrayal, in entirety or in part, then - further to any other relief that you shall be entitled to pursuant to law or pursuant to any other of our undertakings to you incorporated or that shall be incorporated in any document whatsoever - you shall be permitted to consign for immediate defrayal all or some of the debts and undertakings of the company to you, and to collect them from us together with any sum which in the opinion of the bank shall cover the losses and/or expenses that shall be caused to the bank due to the consignment for immediate defrayal as aforementioned.

11. **Additional undertakings in regard to non-defrayal of loans, non-payment of dividends and more**

- 11.1. We shall not pay in any shape or form whatsoever, whether directly or indirectly, to any of our shareholders or to any of our stakeholders who have signed at the foot of this document, including and without derogating from the generality of the aforementioned, the stakeholders and/or family members of any of them and/or corporations under the control of any of them and/or any other third party who shall come in their stead or on their behalf, any sum whatsoever from or on account of the capital notes which the company has issued and/or shall issue in their favour and/or from or on account of loans that have been provided and/or shall be provided to us by any of the aforementioned, or in relation to them, including, however without derogating from the generality of the aforementioned, payments of capital, interest, commissions and expenses (all the above-mentioned sums shall be called hereinafter: “**the loans**”), all without receiving your consent in writing and in advance.
-

- 11.2. We shall not pay and shall not undertake to pay in any shape or form whether directly or indirectly, from the company (from its profits or its capital or from any other source) dividends (as defined in the Companies Law 5729-1999 as it shall be amended from time to time) or interest or management fees or compensation fees or indemnification fees or consultancy fees or sums of money or monetary equivalent (these sums shall be called hereinafter: **“dividends”**) to our shareholders or our stakeholders, whether they have obligated to you at the foot of this document or they have not obligated to you at the foot of this document and/or to a family member or any of them and/or to companies or corporations in which any of our shareholders is a stakeholder and/or to any third party whatsoever who shall come in the place of any of the aforementioned or on behalf of them.
- 11.3. If any request shall be made by any of our shareholders and/or by any other entity of the aforementioned, for any payment whatsoever on account of the sums of the loans and/or the dividends or in relation to them other than pursuant to this document, we shall inform you of this immediately and at your request we shall coordinate with you the actions for cancellation of the request for payment.
-

11.4. Notwithstanding the aforementioned, and for as long as no event has occurred which awards the bank the right to consign our debts to it for immediate defrayal, we shall be permitted to pay the stakeholder, subject to the provisions of the Companies Law and any law, a salary for that service that the stakeholder provides and/or shall provide to us as a “functionary” in the company, including as chairman of the company’s board of directors, president and/or CEO of the company, without the salary being considered as loans and/or dividends, and we shall be permitted to pay to our shareholders every calendar year sums on account of the loans and/or dividends and/or to purchase, to provide financing for purchase or to undertake to purchase or to provide financing for acquisition of company shares, in any shape or form, including but without derogating from the generality of the aforementioned by providing a guarantee, whether directly or indirectly, by the company or by its subsidiary or by another corporation under its control (hereinafter jointly: **“acquisition of company shares”**), all subject to the provisions of the Companies Law and the law, on condition of compliance at all times with the following terms:

11.4.1. The accrued total of sums on account of the loans and/or the dividends that the company shall pay to its shareholders every calendar year shall not exceed a total of 6.5 million US dollars;

11.4.2. The accrued total of sums on account of the acquisition of company shares every calendar year shall not exceed a total of 20 million US dollars;

---

11.4.3. Also after execution of the distribution on account of the loans and/or the dividends and/or the acquisition of the company shares, we shall comply at any time with all the financial criteria to which we have undertaken as aforementioned.

In this section the following terms shall have the following meanings:

**“Corporations under the control of the shareholders”** - any company and any other corporation at the time of signature on this document or which in the future shall be under the control of any of the shareholders or any of our stakeholders who have obligated to you at the foot of this letter.

**“Subsidiary”, “control”, “family member”, “stakeholder”** - as defined in the Securities Law 5728-1968 as shall be in force from time to time.

**“The company shares”** - also including securities that may be converted to company shares and securities that may be realized by company shares.

12. **Validity of the undertakings**

Our aforementioned undertakings shall remain valid for as long as any sums whatsoever are due and/or shall be due to you on account of loans, credit and/or other banking services that you have provided to us and/or shall provide to us in the future and/or for as long as the undertakings and guarantees to you or in your favour shall be valid.

---

In any event that we shall not comply with the financial criteria, in entirety or in part, or if we shall breach any of our other undertakings detailed in this document above, in entirety or in part, then - further to any other relief to which we shall be entitled pursuant to any law or pursuant to any other of our undertakings to you incorporated or that shall be incorporated in any document whatsoever - you shall be permitted to consign for immediate defrayal all or some of our debts and undertakings to you, and to collect from us together with any sum which in the opinion of the bank shall cover the losses and/or expenses that shall be caused to the bank due to the consignment for immediate defrayal as aforementioned.

It is declared that if the bank shall not take action due to a breach of a prior undertaking or due to non-compliance with one or more of our undertakings vis-à-vis the bank, whether that same undertaking is incorporated in this document or whether it is incorporated or shall be incorporated in any other document, this shall not be considered as neglect or a waiver by the bank of its rights and/or as justification or a pretext for continuing with the breach and/or continuing another breach or for not additionally complying with any of our terms or undertakings as aforementioned.

To avoid doubt nothing in the aforementioned shall derogate from our undertakings to you pursuant to any document whatsoever and/or pursuant to law, and nothing in the aforementioned shall derogate from any cause for consignment for immediate defrayal available and/or that shall be available to you pursuant to any document whatsoever and/or pursuant to any law.

---

Yours sincerely,

Stamp: AudioCodes Ltd

Public Co. 520044132

(signature) (signature)

Audiocodes Ltd

---

Date: December 12<sup>th</sup> 2011

Att:

Bank Leumi LeIsrael Ltd

1. I the undersigned, a shareholder, stakeholder and company CEO of Audiocodes Ltd, agree and undertake to comply with all the undertakings aforementioned in this document, inasmuch as they shall relate to me.

Without derogating from the generality of the aforementioned I undertake that no change shall be made to the percentage of my holdings in the share capital and voting rights of the company as compared with the status on the date of signature of this document, as such that it shall reduce my holdings to under the percentage of holdings required pursuant to the Securities Law, 5728-1968, for the purpose of definition a "stakeholder", unless it is with the consent of the bank in writing and in advance.

---

2. Furthermore, and without derogating from that stated in Section 1 above, I, the corporations under my control, and my family members, shall not request, shall not receive, shall not request, shall not expend, directly or indirectly or by any shape or form, any sum whatsoever from or on account of capital notes which the company has issued and/or shall issue in our favour and/or in the favour of any of us and/or from or on account of loans which have been provided and/or shall be provided to the company, including payments of capital, interest, commissions and expenses (all the above-mentioned sums shall be called hereinafter: **“the loans”**).
  3. Furthermore, I undertake that I, the corporations under my control, and my family members shall not request, shall not receive and shall not request and shall not expend from the company (from its profits or from its capital or from any other source) whether directly or indirectly, in any shape or form whatsoever, dividends (as defined in the Companies Law 5759-1999 as it shall be amended from time to time) or interest or management fees or indemnification fees or compensation fees or consultancy fees or any sums of money or monetary equivalent (this sums shall be called hereinafter: **“dividends”**) and we shall not demand and shall not request from the company an undertaking to provide dividends as aforementioned.
  4. Notwithstanding the aforementioned, and for as long as no event has occurred which awards the bank the right to consign the company debts for immediate defrayal, I shall be permitted to receive from the company in every calendar year, subject to the provisions of the Companies Law and the law, a salary for the services that I provide and/or shall provide to the company as a “functionary”, including as chairman of the company’s board of directors, president and/or company CEO, without this salary being considered as a loan and/or dividend, and I shall be permitted to receive from the company every calendar year sums for defrayal of loans and/or payment of dividends subject to the provisions of the Companies Law and the law, on condition of compliance at any time with all the following terms:
-

- 4.1. The accrued total of the sums on account of defrayal of the loans and/or payment of the dividends that the company shall pay to me each calendar year shall not exceed a total of 6.5 million US dollars.
  - 4.2. The accrued total of the sums on account of acquisition of company shares each calendar year shall not exceed a total of 20 million US dollars.
  - 4.3. Even after execution of the distribution on account of the defrayal of the loans and/or payment of the dividends as aforementioned the company shall comply at all times with the financial criteria which they have undertaken pursuant to this aforementioned letter of undertakings.
  5. Furthermore I shall not transfer to another/others whether directly or indirectly all or part of my rights, that exist and that shall exist in the future, vis-à-vis the company for the dividends and/or the loans, without the consent of the bank in writing and in advance.
-



6. Without derogating from the aforementioned, in the event that I and/or the corporations under my control and/or my family members and/or others as aforementioned, shall receive from the company any sum whatsoever on account of or in regard to the loans or the dividends, then we shall transfer to the bank any such sum immediately on its receipt by any of us. The bank shall be permitted to credit as it sees fit any sum that it shall receive from us, for the purpose of defrayal on account of the sums due and/or that shall be due from the company by any means whatsoever.
7. The bank's books and its accounts shall serve as proof *prima facie* of the company's debts to the bank.
8. The aforementioned in this document shall obligate the undersigned, even if some of the shareholders in the company shall not sign on this document.

(signature) \_\_\_\_\_  
\_\_\_\_\_

Stamp: Audicodes Ltd  
Public Co. 520044132  
(signature) (signature)

---

**Letter of amendment prepared and signed on July 24<sup>th</sup> 2012  
to the letter of undertaking signed by Audiocodes Ltd (hereinafter; “the  
company”) on December 12<sup>th</sup> 2011 in favour of Bank Leumi LeIsrael Ltd  
(hereinafter: “the bank”)**

Whereas on December 12<sup>th</sup> 2011 the company signed in favour of the bank on a letter of undertaking according to which the company made various undertakings vis-à-vis the bank, all as detailed in the undertaking attached (hereinafter: “**the letter of undertaking**”)

And whereas the parties have agreed to amend the letter of undertaking as detailed hereinafter:

**Therefore it is declared and agreed between the parties as follows:**

1. The preface to this letter of amendment constitutes an integral part of it thereof.
2. The aforementioned parties hereby agree that the letter of undertaking shall be amended as follows hereinafter:
  - 2.1. Section 1 - under “profitability” - the sub-section hereinafter shall be added:

1.8 The company’s operating profit accrued for four consecutive calendar quarters whereby the date of their termination is the date of the last quarterly financial reports shall not be reduced by more than 15% of the forecasted operating profit that the company presented in the attached appendix in regard to that same period, and the operating profit starting from March 31<sup>st</sup> 2013 shall be positive. To avoid doubt compliance with these undertakings shall also be examined on a quarterly basis.

---

To avoid doubt it is hereby clarified that within the framework of the calculation of the operating profit expenses shall not be taken into account for reduction of intangible assets and/or expenses up to a total of 3 million US dollars for accounting records for the value of the benefit entailed in awarding options to employees pursuant to FAS123.

2.2. In Section 1 - following Section 1.8 - a new heading shall be added: "Financial ratios".

2.3. In Section 1 - under "Financial ratios" - the following sub-section shall be added:

1.9 The ratio between the company's funds including cash and cash equivalents, short term and long term restricted bank deposits, restricted bank deposits and long term marketable securities and the balance of the company's undertakings vis-à-vis banks, financial institutions, bondholders and other lenders including the total undertakings bearing interest plus bank guarantees, SBLC and documentary credit and so forth (without credit for request for securities for the purpose of protection transactions) shall not be less at any time whatsoever than 1.35. To avoid doubt compliance with this undertaking shall also be examined on a quarterly basis.

---

3. All the rest of the terms of the letter of undertaking shall remain fully valid and without any change.

Yours sincerely,

Stamp:

Audicodes Ltd  
Public Co. 520044132  
(signature) \_\_\_\_\_ (signature)  
Audiocodes Ltd

---

	<u>2012A</u> <u>Q1-2012</u>	<u>2012A</u> <u>Q2-2012</u>	<u>2012E</u> <u>Q3-2012</u>	<u>2012E</u> <u>Q4-2012</u>	<u>Total</u> <u>2012</u>	<u>2013E</u> <u>Q1-2012</u>	<u>2013E</u> <u>Q2-2013</u>	<u>2013E</u> <u>Q3-2013</u>	<u>2013E</u> <u>Q4-2013</u>	<u>Total</u> <u>2013</u>
Non GAAP Operating Income (Loss)	-981	-1,200	-2,450	-1,055	-5,698	28	613	1,198	1,490	33,28

Stamp:

Audicodes Ltd  
Public Co. 520044132  
(signature)\_\_\_\_\_ (signature)

Date: July 24<sup>th</sup> 2012

Att:

Audiocodes Ltd (“**the company**”)

Dear Sir or Madam,

Re: **Letter of undertaking dated December 12<sup>th</sup> 2011 (“Letter of Undertaking”)**.

At your request we confirm that if the company data, that shall be published within the framework of the company’s financial reports of June 30<sup>th</sup> 2012 and/or September 30<sup>th</sup> 2012 and/or December 31<sup>st</sup> 2012 and/or December 31<sup>st</sup> 2013 and/or June 30<sup>th</sup> 2013 and/or September 30<sup>th</sup> 2013 (“**the determining reports**”) shall indicate non-compliance by the company with the financial indices detailed in Section 1.7 of the letter of undertaking (“**the agreed financial indices**”), we shall not realize our right to consign for immediate defrayal your debts and undertakings to us due to this.

This confirmation is restricted solely and only to the aforementioned cause and it shall not derogate from our right to consign for immediate defrayal your debts and undertakings for any other cause.

To avoid any doubt it is clarified that our aforementioned waiver is a one-off waiver and relates to the determining reports only; our consent should not be considered to be a waiver to your undertakings to comply with the agreed financial indices after the date of the determining reports, that is after September 30<sup>th</sup> 2013, or as an amendment of the letter of undertaking, and all your undertakings as detailed in the letter of undertaking shall remain in full force.

---

It is also clarified that our consent shall not derogate from our rights to you pursuant to any document that you have signed and/or shall sign for us or pursuant to any law.

This letter shall be conditional on the following terms:

1. You shall receive similar consent from anyone whose non-compliance with any financial indices whatsoever based on the aforementioned determining reports award him the right for immediate defrayal of your debts and undertakings to them, including Bank Mizrahi Tefahot Ltd and The First International Bank Ltd on condition that this consent shall not include conditions that are beneficial to that same entity apart from that stated in this document.
2. You shall sign on a letter of amendment to the letter of undertaking which you signed on December 12<sup>th</sup> 2011 in the attached wording.
3. A total of 1,000,000 US dollars shall be deposited in Account No. #####/## which shall be attached in favour of the bank by a fixed first degree lien.

This letter shall come into force if by no later than July 30<sup>th</sup> 2012 you shall pay us a total of NIS 100,000 for this letter, as has been agreed with you, and you shall present to us a copy of this letter when it is signed by you in the margins.

---

Yours sincerely

Bank Leumi LeIsrael Ltd

We agree to the aforementioned

Stamp:

Audicodes Ltd  
Public Co. 520044132  
(signature)\_\_\_\_\_ (signature)  
Customers' Signature

---



CERTIFICATION PURSUANT TO  
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, Shabtai Adlersberg, certify that:

1. I have reviewed this annual report on Form 20-F of AudioCodes Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 10, 2013

/s/ SHABTAI ADLERSBERG

Shabtai Adlersberg  
Chief Executive Officer

---

CERTIFICATION PURSUANT TO  
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, Guy Avidan, certify that:

1. I have reviewed this annual report on Form 20-F of AudioCodes Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 10, 2013

/s/ GUY AVIDAN

\_\_\_\_\_  
Guy Avidan

Chief Financial Officer

---

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of AudioCodes Ltd. (the "Company") on Form 20-F for the period ending December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Shabtai Adlersberg, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: April 10, 2013

/s/ SHABTAI ADLERSBERG

---

Shabtai Adlersberg  
Chief Executive Officer

---

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of AudioCodes Ltd. (the "Company") on Form 20-F for the period ending December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Guy Avidan, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: April 10, 2013

/s/ GUY AVIDAN

---

Guy Avidan  
Chief Financial Officer

---

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-11894, 333-13268, 333-105473, 333-144825, 333-160330 and 333-170676) and Form F-3 (No. 333-172268) of our reports dated April 10, 2013 with respect to the consolidated financial statements of AudioCodes Ltd. for the year ended December 31, 2012, and the effectiveness of internal control over financial reporting of AudioCodes Ltd. included in this Annual Report on Form 20-F for the year ended December 31, 2012, filed with the Securities and Exchange Commission.

Tel Aviv, Israel

/s/ KOST, FORER, GABBAY AND KASIERER  
KOST, FORER, GABBAY AND KASIERER

April 10, 2013

A member of Ernst & Young Global

---