



NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006

IN U.S. DOLLARS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

NICE SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of NICE Systems Ltd. and subsidiaries ("the Company") as of December 31, 2005 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. 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 as of December 31, 2005 and 2006, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, in 2006 the Company adopted Statement Financial Accounting Standards Board No. 123 (revised 2004) "Share-Based Payment".

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 12, 2007 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
June 12, 2007

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**To the Shareholders and Board of Directors of****NICE SYSTEMS LTD.**

We have audited management's assessment, which is contained in Part II, Item 15 of this annual report on form 20-F under the heading "Management's Annual Report on Internal Control Over Financial Reporting", that NICE Systems Ltd. ("the Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("the COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

As indicated in Part II, Item 15 of this annual report on form 20-F under the heading "Management's Annual Report on Internal Control Over Financial Reporting", management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal control over financial reporting of IEX corporation Inc ("IEX") because it was acquired during 2006. IEX is included in the 2006 consolidated financial statements of the Company since July 7, 2006 and constituted approximately 29% of total assets as of December 31, 2006 and 5% of total revenues for the year then ended. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of IEX.



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In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006 and our report dated June 12, 2007 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
June 12, 2007

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2005	2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 254,956	\$ 67,365
Short-term bank deposits	102	130
Marketable securities	36,159	92,859
Trade receivables (net of allowance for doubtful accounts of \$ 2,214 and \$ 1,951 at December 31, 2005 and 2006, respectively)	66,153	81,312
Other receivables and prepaid expenses	9,544	11,399
Inventories	23,172	18,619
Deferred tax assets	3,360	14,478
<u>Total current assets</u>	<u>393,446</u>	<u>286,162</u>
LONG-TERM ASSETS:		
Marketable securities	120,342	135,810
Investment in affiliates	1,200	1,200
Severance pay fund	7,907	9,998
Other receivables and prepaid expenses	648	832
Deferred tax assets	4,976	2,917
Property and equipment, net	14,888	15,813
Other intangible assets, net	23,990	111,182
Goodwill	49,853	220,430
<u>Total long-term assets</u>	<u>223,804</u>	<u>498,182</u>
<u>Total assets</u>	<u>\$ 617,250</u>	<u>\$ 784,344</u>

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2005	2006
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 18,194	\$ 22,845
Accrued expenses and other liabilities	100,544	146,990
<u>Total current liabilities</u>	<u>118,738</u>	<u>169,835</u>
LONG-TERM LIABILITIES:		
Accrued severance pay	8,901	11,743
Deferred tax liabilities	2,493	33,130
Other long-term liabilities	77	62
<u>Total long-term liabilities</u>	<u>11,471</u>	<u>44,935</u>
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital-		
Ordinary shares of NIS 1 par value:		
Authorized: 75,000,000 and 125,000,000 at December 31, 2005 and 2006, respectively; Issued and outstanding: 48,275,286 and 51,091,512 shares at December 31, 2005 and 2006, respectively;	6,772	12,754
Additional paid-in capital	473,203	522,866
Accumulated other comprehensive income	2,996	7,483
Retained earnings	4,070	26,471
<u>Total shareholders' equity</u>	<u>487,041</u>	<u>569,574</u>
<u>Total liabilities and shareholders' equity</u>	<u>\$ 617,250</u>	<u>\$ 784,344</u>

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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

	Year ended December 31,		
	2004	2005	2006
Revenues:			
Products	\$ 182,616	\$ 206,355	\$ 261,098
Services	70,027	104,755	148,546
<u>Total revenues</u>	<u>252,643</u>	<u>311,110</u>	<u>409,644</u>
Cost of revenues:			
Products	64,432	67,543	84,675
Services	49,876	68,683	89,539
<u>Total cost of revenues</u>	<u>114,308</u>	<u>136,226</u>	<u>174,214</u>
Gross profit	<u>138,335</u>	<u>174,884</u>	<u>235,430</u>
Operating expenses:			
Research and development, net	24,866	30,896	44,880
Selling and marketing	61,855	72,829	95,190
General and administrative	31,269	37,742	60,463
Amortization of acquired intangibles	317	1,331	4,918
In process research and development write-off	-	-	12,882
<u>Total operating expenses</u>	<u>118,307</u>	<u>142,798</u>	<u>218,333</u>
Operating income	20,028	32,086	17,097
Financial income, net	3,556	5,398	13,272
Other income (expenses), net	54	(13)	623
Income before taxes on income	23,638	37,471	30,992
Taxes on income	2,319	902	8,591
Net income from continuing operations	21,319	36,569	22,401
Net income from discontinued operation	3,236	-	-
Net income	<u>\$ 24,555</u>	<u>\$ 36,569</u>	<u>\$ 22,401</u>
Net earnings per share:			
Basic:			
Continuing operations	\$ 0.61	\$ 0.95	\$ 0.45
Discontinued operation	0.09	-	-
Basic net earnings per share	<u>\$ 0.70</u>	<u>\$ 0.95</u>	<u>\$ 0.45</u>
Diluted:			
Continuing operations	\$ 0.57	\$ 0.89	\$ 0.43
Discontinued operation	0.09	-	-
Diluted net earnings per share	<u>\$ 0.66</u>	<u>\$ 0.89</u>	<u>\$ 0.43</u>

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (accumulated deficit)	Total comprehensive income	Total shareholders' equity
Balance as of January 1, 2004	\$ 5,142	\$ 224,855	\$ 3,888	\$ (57,054)		\$ 176,831
Issuance of shares of ESPP	31	2,234				2,265
Exercise of share options	291	17,311				17,602
Comprehensive income:						
Foreign currency translation adjustments	-	-	1,617	-	\$ 1,617	1,617
Unrealized gains on derivative instruments, net	-	-	1	-	1	1
Net income	-	-	-	24,555	24,555	24,555
Total comprehensive income					<u>\$ 26,173</u>	
Balance as of December 31, 2004	5,464	244,400	5,506	(32,499)		222,871
Issuance of shares upon public offering, net	1,003	201,377	-	-		202,380
Issuance of shares of ESPP	37	4,285	-	-		4,322
Exercise of share options	268	21,640	-	-		21,908
Tax Benefit in respect of exercised options	-	1,501	-	-		1,501
Comprehensive income:						
Foreign currency translation adjustments	-	-	(2,493)	-	\$ (2,493)	(2,493)
Unrealized losses on derivative instruments, net	-	-	(17)	-	(17)	(17)
Net income	-	-	-	36,569	36,569	36,569
Total comprehensive income					<u>\$ 34,059</u>	
Balance as of December 31, 2005	6,772	473,203	2,996	4,070		487,041
Issuance of shares of ESPP	2	227	-	-		229
Exercise of share options	510	37,187	-	-		37,697
Stock-based compensation	-	12,571	-	-		12,571
Adjustment to tax benefit in respect of offering expenses	-	(585)	-	-		(585)
Excess tax benefit from share based payment arrangements	-	5,733	-	-		5,733
Stock split effected as stock dividend	5,470	(5,470)	-	-		-
Comprehensive income:						
Foreign currency translation adjustments	-	-	4,463	-	\$ 4,463	4,463
Unrealized losses on derivative instruments, net	-	-	24	-	24	24
Net income	-	-	-	22,401	22,401	22,401
Total comprehensive income					<u>\$ 26,888</u>	
Balance as of December 31, 2006	<u>\$ 12,754</u>	<u>\$ 522,866</u>	<u>\$ 7,483</u>	<u>\$ 26,471</u>		<u>\$ 569,574</u>
Accumulated unrealized gains on derivative instruments			\$ 72			
Accumulated foreign currency translation adjustments			7,411			
Accumulated other comprehensive income as of December 31, 2006			<u>\$ 7,483</u>			

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2004	2005	2006
<u>Cash flows from operating activities:</u>			
Net income	\$ 24,555	\$ 36,569	\$ 22,401
Less: net income from discontinued operation	(3,236)	-	-
Net income from continuing operations	21,319	36,569	22,401
Adjustments required to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations:			
Depreciation and amortization	13,793	13,152	21,919
Stock-based compensation	-	-	12,571
Excess tax benefit from share-based payments arrangements	-	-	(5,733)
Tax benefit from exercised options	-	1,501	-
In-process research and development write-off	-	-	12,882
Accrued severance pay, net	37	187	751
Amortization of premium (accretion of discount) and accrued interest on held-to-maturity marketable securities	1,205	812	278
Deferred taxes, net	-	(4,841)	(3,707)
Increase in trade receivables	(585)	(11,488)	(6,772)
Decrease (increase) in other receivables and prepaid expenses	(654)	566	(1,897)
Decrease (increase) in inventories	(122)	(3,930)	5,376
Increase (decrease) in trade payables	(3,761)	5,782	1,435
Increase in accrued expenses and other liabilities	13,043	27,339	27,991
Other	(7)	54	80
Net cash provided by operating activities from continuing operations	44,268	65,703	87,575
Net cash provided by operating activities from discontinued operation	750	-	-
Net cash provided by operating activities	45,018	65,703	87,575

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2004	2005	2006
<u>Cash flows from investing activities:</u>			
Purchase of property and equipment	(6,701)	(6,128)	(8,111)
Proceeds from sale of property and equipment	89	66	76
Investment in marketable securities	(122,192)	(218,472)	(217,655)
Proceeds from maturity of marketable securities	17,710	190,682	142,209
Proceeds from sale and call of held-to-maturity marketable securities	41,345	9,630	3,000
Investment in short-term bank deposits	(129)	(39)	(117)
Proceeds from short-term bank deposits	149	108	99
Refund (payment) for the acquisition of certain assets and liabilities of Dictaphone CRS division (a)	-	(39,724)	2,000
Payment for the acquisition of certain assets and liabilities of Hannamax Hi-Tech Pty. Ltd. (b)	-	(1,889)	(500)
Payment for the acquisition of FAST (c)	-	-	(21,320)
Payment for the acquisition of Performix (d)	-	-	(13,800)
Payment for the acquisition of IEX (e)	-	-	(203,162)
Decrease in accrued acquisition costs	(75)	-	(15)
Payments and proceeds in respect of TCS acquisition	(1,236)	2,531	-
Capitalization of software development costs	(1,305)	(806)	(1,225)
Deferred acquisition costs	-	(256)	-
Other	-	-	83
Net cash used in investing activities from continuing operations	(72,345)	(64,297)	(318,438)
Net cash provided by investing activities from discontinued operation	4,136	-	-
Net cash used in investing activities	(68,209)	(64,297)	(318,438)
<u>Cash flows from financing activities:</u>			
Proceeds from issuance of shares upon public offering, net	-	201,724	-
Proceeds from issuance of shares upon exercise of options and ESPP	19,867	25,259	38,987
Excess tax benefit from share-based payments arrangements	-	-	5,733
Decrease in accrued offering expenses	-	-	(273)
Decrease in short-term bank credit assumed in the acquisition of FAST	-	-	(785)
Net cash provided by financing activities	19,867	226,983	43,662
Effect of exchange rate changes on cash	44	(12)	(390)
Increase (decrease) in cash and cash equivalents	(3,280)	228,377	(187,591)
Cash and cash equivalents at the beginning of the year	29,859	26,579	254,956
Cash and cash equivalents at the end of the year	<u>\$ 26,579</u>	<u>\$ 254,956</u>	<u>\$ 67,365</u>
<u>Supplemental disclosure of cash flows activities:</u>			
Cash paid during the year for:			
Income taxes	<u>\$ 598</u>	<u>\$ 389</u>	<u>\$ 1,407</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,		
	2004	2005	2006
(a) <u>Payment for the acquisition of certain assets and liabilities of Dictaphone CRS division:</u>			
Fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)	\$ (913)		(3,000)
Property and equipment	202		-
Other Intangible assets	15,400		-
Goodwill	25,311		1,000
		40,000	-
Less - accrued acquisition costs		(276)	-
	<u>\$ 39,724</u>		<u>\$ (2,000)</u>
(b) <u>Payment for the acquisition of certain assets and liabilities of Hannamax Hi-Tech Pty. Ltd.</u>			
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)	\$ (50)		\$ -
Property and equipment	10		-
Other intangible assets	930		-
Goodwill	1,159		500
Other long-term liabilities	(38)		-
		2,011	-
Less - accrued acquisition costs		(122)	-
	<u>\$ 1,889</u>		<u>\$ 500</u>
(c) <u>Payment for the acquisition of FAST:</u>			
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)			\$ (5)
Property and equipment			256
In-process research and development			212
Other intangible assets			11,753
Goodwill			17,042
Long-term deferred tax liability			(1,449)
			27,809
Less – decrease in prepaid acquisition costs			(256)
Less - accrued acquisition costs			(6,233)
			<u>\$ 21,320</u>

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2004	2005	2006
(d) <u>Payment for the acquisition of Performix:</u>			
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)			\$ (2,800)
Property and equipment			360
Other intangible assets			8,060
Goodwill			8,292
Long-term deferred tax liability			(24)
			13,888
Less - accrued acquisition costs			(88)
			<u>\$ 13,800</u>
(e) <u>Payment for the acquisition of IEX:</u>			
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)			\$ 1,687
Property and equipment			315
In-process research and development			12,670
Other intangible assets			78,170
Goodwill			140,900
Long-term deferred tax liabilities			(28,909)
			204,833
Less - accrued acquisition costs			(1,671)
			<u>\$ 203,162</u>
(f) <u>Non-cash activities:</u>			
Adjustment of goodwill in respect of discontinued operation sale	<u>\$ (250)</u>	<u>\$ -</u>	<u>\$ -</u>
Tax benefit on offering expenses	<u>\$ -</u>	<u>\$ 1,002</u>	<u>\$ (585)</u>
Accrued offering expenses	<u>\$ -</u>	<u>\$ 346</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. General:

NICE Systems Ltd. ("NICE") and subsidiaries (collectively - "the Company") develop, market and support integrated, scalable multimedia digital recording platforms, enhanced software applications and related professional services. These solutions capture and analyze unstructured (non-transaction) data and convert it for business and security performance management applications. The Company's solutions capture multiple forms of interaction, including voice, fax, email, web chat, radio, and video transmissions over wire line, wireless, packet telephony, terrestrial trunk radio and data networks.

The Company's products are based on two types of recording platforms - audio and video. The Company's solutions are offered to various vertical markets in two major sectors: (1) the Enterprise Interaction Solutions Sector - contact centers and trading floors and (2) the Public Safety and Security Sector - safety organizations, transportation, corporate security, gaming and correctional facilities and government and intelligence agencies.

The Company's products are sold primarily through a global network of distributors, system integrators and strategic partners; a portion of product sales and most services are sold directly to end-users.

The Company's markets are located primarily in North America, Europe, the Middle East and Africa ("EMEA") and Asia Pacific ("APAC").

The Company depends on a limited number of contract manufacturers for producing its products. If any of these manufacturers become unable or unwilling to continue to manufacture or fail to meet the quality or delivery requirements needed to satisfy the Company's customers, it could result in the loss of sales, which could adversely affect the Company's results of operations and financial position.

The Company relies upon a number of independent distributors to market, sell and service its products in certain markets. If the Company is unable to effectively manage and maintain relationships with its distributors, or to enter into similar relationships with others, its ability to market and sell its products in these markets will be affected. In addition, a loss of a major distributor, or any event negatively affecting such distributors' financial condition, could cause a material adverse effect on the Company's results of operations and financial position.

As for major customer data, see Note 15c.

b. Acquisitions:

1. Acquisition of Dictaphone's Communications Recording Systems ("CRS"):

On June 1, 2005, the Company consummated an agreement to acquire the assets and assume certain liabilities of Dictaphone's Communications Recording Systems ("CRS") business for \$ 40,000 (including acquisition costs). Dictaphone's CRS business is a leading provider of liability and quality management systems for first responders, critical facilities, contact centers and financial trading floors.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

On March 27, 2006, the Company and Dictaphone agreed to amend the CRS's purchase agreement, according to which, Dictaphone paid to the Company \$ 2,000 as a final adjustment to the purchase price under the purchase agreement.

The acquisition of CRS expanded the Company's customer base, presence in the U.S and Europe markets, and its network of distributors and partners. Additionally, the Company broadened its product offerings and global professional services team.

By purchasing CRS, the Company strategically expanded its market share both in geographical and vertical markets. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share, strategic positioning value and time-to-market benefits.

The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of CRS. The results of the CRS's operations have been included in the consolidated financial statements since June 1, 2005 ("the closing date").

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Trade receivables	\$ 6,561
Other receivables and prepaid expenses	25
Inventories	7,426
Property and equipment	198
Trademarks	400
Core technology	4,900
Distribution network	10,100
Goodwill	<u>26,311</u>
 Total assets acquired	 <u>55,921</u>
 Trade payables	 (569)
Accrued expenses and other liabilities	<u>(17,352)</u>
 Total liabilities assumed	 <u>(17,921)</u>
 Net assets acquired	 <u><u>\$ 38,000</u></u>

Trademarks, core technology and distribution network in the amount of \$ 15,400 are amortized using the straight-line method at an annual weighted average rate of 19.5%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

In connection with Dictaphone's patent infringement claim against the Company (filed in June 2000), the Company reached a settlement agreement with Dictaphone (in December 2003) and agreed to dismiss all claims and counterclaims. In connection with the settlement agreement, each of the companies granted the other a perpetual license to certain of their respective patents including the disputed patents. Because the rights were restrictive in terms of transferability, enforceability and the right to sublicense by the grantee, the Company determined that the rights obtained and granted were of equivalent and insignificant value and, therefore, no separate amounts were recorded in the business combination in accordance with Emerging Issues Task Force ("EITF") 04-01 "Accounting for Preexisting Relationship between the parties to a Business combination".

2. Acquisition of Hannamax Hi-Tech Pty. Ltd, ("Hannamax"):

On September 1, 2005, the Company consummated an agreement to acquire the assets and assume certain liabilities of Hannamax Hi-Tech Pty. Ltd, ("Hannamax") business for \$ 2,011 (including acquisition costs), with potential earn out cash payment of up to \$ 1,000 based on certain financial performance criteria covering 2005 through 2006. In the second quarter of 2006, the Company paid additional consideration in the amount of \$ 500 due to meeting the performance criteria relating to year 2005. Accordingly, the Company recorded additional goodwill in the amount of \$ 500.

In the second quarter of 2007, the Company paid an additional consideration in the amount of \$ 500 in respect of Hannamax acquisition, due to meeting the performance criteria specified in the acquisition agreement relating to year 2006. Accordingly, the Company recorded additional goodwill in the amount of \$ 500 in the second quarter of 2007.

Hannamax is NICE's distributor in Australia and New Zealand markets. With the acquisition of Hannamax, the Company expects to expand its customer base and presence in Australia and New Zealand and to expand and strengthen the Company's support organization in the region.

The factors that contributed to the purchase price that resulted in recognition of goodwill included: the benefits of increased market share geographically, the benefits of vertical integration and time-to-market benefits.

The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of Hannamax. The results of Hannamax's operations have been included in the consolidated financial statements since September 1, 2005 ("the closing date").

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Trade receivables	\$ 332
Other receivables and prepaid expenses	16
Inventories	318
Property and equipment	10
Customer relationships	930
Goodwill	<u>1,659</u>
 Total assets acquired	 <u>3,265</u>
 Trade payables	 (91)
Accrued expenses and other liabilities	(625)
Other long-term liability	<u>(38)</u>
 Total liabilities assumed	 <u>(754)</u>
 Net assets acquired	 <u>\$ 2,511</u>

Customer relationships in the amount of \$ 930 are amortized using the straight-line method at an annual rate of 10%.

3. Acquisition of FAST Video Security AG ("FAST"):

On January 4, 2006, the Company consummated an agreement to acquire all of the outstanding shares of FAST, a Switzerland-based developer of innovative video systems for security and surveillance purposes. Under the agreement, the Company acquired FAST for \$ 21,650 in cash (including acquisition costs), with potential earn out based on performance milestones amounting to a maximum of \$ 12,000 payable over the next three years.

During the fourth quarter of 2006 the Company estimated that an additional consideration for earn out in the amount of approximately \$ 6,200 will be paid by the Company on account of 2006 earn out; accordingly, the Company recorded additional goodwill in this amount.

The acquisition of FAST strengthens the Company's position in the video security market with smart IP-based solutions and technologies complementary to the Company's existing digital video offerings. Additionally, the Company extends its presence in the digital video security market by increasing its footprint in Europe and APAC markets with high quality distribution channels and partners, and with new prestigious customers.

By purchasing FAST, the Company strategically expanded its market share both in geographical and vertical markets. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share, strategic positioning value and time-to-market benefits.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of FAST. The results of FAST's operations have been included in the consolidated financial statements since January 4, 2006 ("the closing date").

Should any contingent payment be made under the agreement in the future, the additional consideration, when determinable, will increase the purchase price and accordingly additional goodwill will be recorded.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Cash	\$ 38
Trade receivables	1,869
Other receivables and prepaid expenses	975
Inventories	296
Property and equipment	256
Trademarks	484
Core technology	9,869
In-process research and development	212
Customer relationships	1,400
Goodwill	17,042
	<hr/>
Total assets acquired	32,441
	<hr/>
Short-term bank credit	(785)
Trade payables	(1,568)
Accrued expenses and other liabilities	(792)
Long-term deferred tax liability	(1,449)
	<hr/>
Total liabilities assumed	(4,594)
	<hr/>
Net assets acquired	<u>\$ 27,847</u>

The \$ 212 assigned to in-process research and development was written off at the acquisition date in accordance with FASB Interpretation ("FIN") No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method".

Trademarks, core technology and customer relationships in the amount of \$ 11,753 are amortized using the straight-line method at an annual weighted average rate of 20%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

4. Acquisition of Performix:

On May 22, 2006, the Company consummated an agreement to acquire all of the outstanding shares of Performix Software Limited and to acquire the assets and assume certain liabilities of Performix Holdings Inc. and its subsidiaries (collectively "Performix"). Under the agreement, the Company acquired Performix for a total purchase price of \$ 13,910 in cash (including acquisition costs). The purchase price may increase by up to an additional \$ 3,150 based on certain performance criteria for the twelve month period ending July 1, 2007.

Performix was among the first to recognize the potential in the area of contact center performance management (CCPM), an emerging trend in the contact center market. The acquisition of Performix extends NICE's solutions portfolio for the contact center market.

The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share vertically, strategic positioning value and time-to-market benefits.

The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of Performix. The results of Performix's operations have been included in the consolidated financial statements since May 22, 2006 ("the closing date").

Should any contingent payment be made under the agreement in the future, the additional consideration, when determinable, will increase the purchase price and accordingly additional goodwill will be recorded.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Cash	\$ 22
Trade receivables	724
Other receivables and prepaid expenses	325
Property and equipment	360
Trade name	580
Core technology	5,790
Customer relationships and distribution network	1,690
Goodwill	8,292
	<hr/>
Total assets acquired	17,783
	<hr/>
Trade payables	(1,328)
Accrued expenses and other liabilities	(2,521)
Long-term deferred tax liability	(24)
	<hr/>
Total liabilities assumed	(3,873)
	<hr/>
Net assets acquired	\$ 13,910
	<hr/> <hr/>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

Trade name, core technology, customer relationships and distribution network in the amount of \$ 8,060 are amortized using the straight-line method at an annual weighted average rate of 26%.

5. Acquisition of IEX:

On July 7, 2006, the Company consummated an agreement to acquire all of the outstanding shares of IEX Corporation ("IEX"), a worldwide provider of contact center workforce management solutions. Under the agreement, the Company acquired the shares of IEX, a wholly owned subsidiary of Tekelec, for approximately \$ 204,900 in cash (including acquisition costs).

The acquisition of IEX allows NICE to offer its customers and partners a more extensive product portfolio in the industries in which NICE operates. IEX is a leading vendor in workforce management, strategic planning and performance management solutions for the contact center market. IEX provides a high-end centralized solution that compiles data seamlessly across the enterprise, enabling more accurate and effective forecasting, planning and scheduling.

By purchasing IEX, the Company strategically expanded its market share both in geographical and vertical markets. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share, strategic positioning value and time-to-market benefits.

The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of IEX. The results of the IEX operations have been included in the consolidated financial statements since July 7, 2006 ("the closing date").

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Cash	\$ 67
Trade receivables	7,364
Other receivables and prepaid expenses	346
Inventories	1,016
Short-term deferred tax assets	9,007
Property and equipment	315
Trade name	4,090
Core technology	35,060
In-process research and development	12,670
Customer relationships	39,020
Goodwill	<u>140,900</u>
 Total assets acquired	 <u>249,855</u>
 Trade payables	 (292)
Accrued expenses and other liabilities	(12,838)
Short-term deferred tax liabilities	(2,916)
Long-term deferred tax liabilities	<u>(28,909)</u>
 Total liabilities assumed	 <u>(44,955)</u>
 Net assets acquired	 <u>\$ 204,900</u>

The \$ 12,670 assigned to in-process research and development was written off at the acquisition date in accordance with FASB Interpretation ("FIN") No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method".

Trade name, core technology and customer relationships in the amount of \$ 78,170 are amortized using the straight-line method at an annual weighted average rate of 12%. Amortization expense for the above-mentioned intangible assets for the five years ending December 31, 2011 is estimated to be \$ 45,512.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 1:- GENERAL (Cont.)**

6. Unaudited pro-forma condensed results of operations:

The following represents the unaudited pro-forma condensed results of operations for the years ended December 31, 2005 and 2006, assuming that the acquisitions of CRS, Hannamax, FAST, Performix and IEX occurred on January 1, 2005 and 2006, respectively. The pro-forma information is not necessarily indicative of the results of operations, which actually would have occurred had the acquisitions been consummated on that dates, nor does it purport to represent the results of operations for future periods.

	Year ended December 31,	
	2005	2006
	Unaudited	
Revenues	<u>\$ 401,651</u>	<u>\$ 447,915</u>
Net income	<u>\$ 21,011</u>	<u>\$ 38,473</u>
Basic net earnings per share	<u>\$ 0.55</u>	<u>\$ 0.78</u>
Diluted net earnings per share	<u>\$ 0.51</u>	<u>\$ 0.73</u>

c. Disposal by sale of the COMINT/DF operation:

In 2003, the Company reached a definitive agreement to sell the assets and liabilities of its COMINT/DF military-related business to ELTA Systems Ltd. for \$ 4,000 in cash. On March 31, 2004, the Company completed the sale of the COMINT/DF operation. The COMINT/DF business was treated as a discontinued operation in the financial statements.

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 were prepared in accordance with United States Generally Accepted Accounting Principles ("U.S. GAAP").

a. Use of estimates:

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

b. Financial statements in United States dollars:

The currency of the primary economic environment in which the operations of NICE and certain subsidiaries are conducted is the U.S. dollar ("dollar"); thus, the dollar is the functional currency of NICE and certain subsidiaries.

NICE and certain subsidiaries' transactions and balances denominated in dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured to dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation". All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statements of operations as financial income or expenses, as appropriate.

For those subsidiaries whose functional currency has been determined to be their local currency, assets and liabilities are translated at year-end exchange rates and statement of operations items are translated at average exchange rates prevailing during the year. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

c. Principles of consolidation:

Intercompany transactions and balances have been eliminated upon consolidation.

d. Cash equivalents:

The Company considers short-term unrestricted highly liquid investments that are readily convertible into cash, purchased with maturities of three months or less to be cash equivalents.

e. Short-term bank deposits:

Bank deposits with maturities of more than three months but less than one year are included in short-term bank deposits. Such short-term bank deposits are stated at cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Marketable securities:

The Company accounts for investments in debt securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date.

Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity and are stated at amortized cost. The cost of held-to-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization, accretion, decline in value judged to be other than temporary, and interest are included in financial income or expenses, as appropriate.

Interest income resulting from investments in structured notes that are classified as held to maturity is accounted for under the provision of EITF No. 96-12, "Recognition of Interest Income and Balance Sheet Classification of Structured Notes". Under Emerging Issues Task Force ("EITF") No. 96-12, the retrospective interest method is used for recognizing interest income.

Auction rate securities are classified as available-for-sale and accordingly, these securities are stated at fair value. Realized gains and losses on sales of securities, as determined on a specific identification basis, are included in the consolidated statement of income.

g. Inventories:

Inventories are stated at the lower of cost or market value. The cost of raw materials and work-in-progress is determined by the "average cost" method, and the cost of finished goods on the basis of costs charged by third party manufacturer.

Inventory provisions are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and discontinued products and for market prices lower than cost. Inventory provisions for 2004, 2005 and 2006 were \$ 2,822, \$ 4,646 and \$ 5,095, respectively, and have been included in cost of revenues.

h. Investment in affiliates:

The investments in affiliated companies are stated at cost, since the Company does not have the ability to exercise significant influence over operating and financial policies of those investees.

The Company's investment in affiliates is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- i. Property and equipment, net:

Property and equipment are stated at cost, net of accumulated depreciation.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	<u>%</u>
Computers and peripheral equipment	33
Office furniture and equipment	6 - 15
Motor vehicles	15

Leasehold improvements are amortized by the straight-line method over the term of the lease or the estimated useful life of the improvements, whichever is shorter.

- j. Other intangible assets, net:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets".

Amortization is calculated using the straight-line method over the estimated useful lives at the following annual rates:

	<u>Weighted average %</u>
Capitalized software development costs (see n)	33
Core technology	17
Trademarks	22
Distribution network	11
Maintenance contracts	33

- k. Impairment of long-lived assets:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Goodwill:

Goodwill represents the excess of the cost over the fair value of the net assets of businesses acquired. Under SFAS No. 142, goodwill is not amortized.

SFAS No. 142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is determined using discounted cash flows and market capitalization. Significant estimates used in the fair value methodologies include estimates of future cash flows, future growth rates and the weighted average cost of capital of the reporting unit. The Company performed annual impairment tests during the fourth quarter of 2004, 2005 and 2006 and did not identify any impairment losses.

m. Revenue recognition:

The Company generates revenues from sales of products, which include hardware and software, software licensing, professional services and maintenance. Professional services include installation, project management and training. The Company sells its products indirectly through a global network of distributors, system integrators and strategic partners, all of whom are considered end-users, and through its direct sales force.

Revenues from sales of product and software licensing are recognized when all criteria outlined in Statement Of Position ("SOP") 97-2, "Software Revenue Recognition" (as amended by SOP 98-9) are met. Revenue from products and software licensing is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectibility is probable.

In transactions, where a customer's contractual terms include a provision for customer acceptance, revenues are recognized either when such acceptance has been obtained or as the acceptance provision has lapsed.

With regard to arrangements involving multiple elements, the Company applies Statement of Position No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions" ("SOP No. 98-9"). According to SOP No. 98-9, revenues should be allocated to the different elements in the arrangement under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the residual method, at the outset of the arrangement with the customer, the Company defers revenue for the fair value of its undelivered elements (maintenance and professional services) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (products and software licenses) when the basic criteria in SOP No. 97-2 have been met. Any discount in the arrangement is allocated to the delivered element.

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 policy for establishing VSOE of fair value of maintenance services is based on the price charged when the maintenance is sold separately i.e. based on the renewal activity for the installed base of the Company. Establishment of VSOE of fair value of installation and training services is based on the price charged when these elements are sold separately. VSOE of fair value to the project management services is established based on a price per day which is identical to price per day charged for installation services.

The Company maintains a provision for product returns in accordance with SFAS No. 48, "Revenue Recognition When Right of Return Exists". The provision is estimated based on the Company's past experience and is deducted from revenues. Trade receivables as of December 31, 2005 and 2006, are presented net of provision for product returns in the amounts of \$ 1,155 and \$ 1,975 respectively.

Revenues from maintenance and professional services are recognized ratably over the contractual period or as services are performed.

Deferred revenue includes advances and payments received from customers, for which revenue has not yet been recognized.

n. Research and development costs:

Research and development costs (net of grants and participations) incurred in the process of software production before establishment of technological feasibility, are charged to expenses as incurred. Costs of the production of a product master incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed". Based on the Company's product development process, technological feasibility is established upon completion of a detailed program design.

Costs incurred by the Company between completion of the detailed program design or working model and the point at which the product is ready for general release have been capitalized.

Capitalized software development costs are amortized commencing with general product release by the straight-line method over the estimated useful life of the software product.

o. Income taxes:

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Government grants:

Non-royalty bearing grants from the Government of Israel for funding research and development projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred and recorded as a deduction from research and development costs.

q. Concentrations of credit risk:

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

The Company's cash and cash equivalents and short-term bank deposits are invested in deposits mainly in dollars with major international banks. Such deposits 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 Company's investments are financially sound and, accordingly, low credit risk exists with respect to these investments.

The Company's trade receivables are derived from sales to customers located primarily in North America, EMEA and the Far East. The Company performs ongoing credit evaluations of its customers and obtains letter of credit and bank guarantees for certain receivables. Additionally, the Company insures certain of its receivables with a credit insurance company. An allowance for doubtful accounts is provided with respect to specific debts that the Company has determined to be doubtful of collection and a general provision on the remaining balance, based on the length of time the receivables are past due.

The Company's marketable securities include investment in U.S. corporate debentures, U.S government debentures, structured notes and auction rate securities. Management believes that the portfolio is well diversified, and accordingly, low credit risk exists with respect to those marketable securities.

The Company entered into forward contracts and option strategies (together: "derivative instruments") intended to protect against the increase in value of forecasted non-dollar currency cash flows and the increase/decrease in fair value of non-dollar liabilities/assets. The derivative instruments effectively hedge the Company's non-dollar currency exposure (see Note 10).

r. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to Israeli severance pay law based on the most recent monthly salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment, or a portion thereof. The Company's liability is fully provided by monthly deposits with insurance policies and severance pay funds and by an accrual.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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 Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes immaterial profits.

Severance pay expense for 2004, 2005 and 2006 was \$ 2,956, \$ 3,622 and \$ 4,305, respectively.

The Company has a 401(K) defined contribution plan covering certain employees in the U.S. All eligible employees may elect to contribute up to 6%, but generally not greater than \$ 15 per year, (for certain employees over 50 years of age the maximum contribution is \$ 20 per year) of their annual compensation to the plan through salary deferrals, subject to IRS limits. The Company matches 50% of employee contributions to the plan up to a limit of 6% of their eligible compensation. In the years 2004, 2005, and 2006 the Company recorded expense for matching contributions in the amount of \$ 547, \$ 812 and \$ 1,176 respectively.

s. Basic and diluted net earnings 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 dilutive potential equivalent Ordinary shares considered outstanding during the year, in accordance with SFAS No. 128, "Earnings Per Share".

The weighted average number of shares related to outstanding antidilutive options excluded from the calculations of diluted net earnings per share was 2,189,550, 1,937,222 and 705,589 for the years ended December 31, 2004, 2005 and 2006, respectively.

t. Accounting for Stock-based compensation:

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), for periods beginning in fiscal year 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated income statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Prior to January 1, 2006, the Company accounted for options granted to employees and directors under the recognition and measurement provisions of APB 25 as permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") whereby compensation expenses is equal to the excess, if any of the quoted market price of the stock over the exercise price at the grant date of the award. During the years ended December 31, 2004 and 2005, the Company did not recognize any stock-based compensation expense related to employee stock options.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

The Company recognizes compensation expenses for the value of its awards, which have graded vesting, based on the accelerated attribution method over the requisite service period of each of the awards, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's income before taxes on income and net income for the year ended December 31, 2006, is approximately \$ 12,571 and \$ 10,424 lower, respectively, than if it had continued to account for stock-based compensation under APB 25. Basic and diluted net earnings per share for the year ended December 31, 2006 are \$ 0.21 and \$ 0.20 lower, respectively, than if the Company had continued to account for stock-based compensation under APB 25.

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing model. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. Federal Reserve zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value of the Company's stock options granted to employees and directors for the year ended December 31, 2006 was estimated using the following assumptions:

Expected volatility	33.9%-40.6%
Weighted average volatility	40.0%
Risk free interest rate	4.6%-4.9%
Expected dividend	0%
Expected term (in years)	2.3-3.7

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

A summary of the Company's stock options activity and related information for the year ended December 31, 2006, is as follows:

	Number of options	Weighted- average exercise price	Weighted- average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2006	8,136,754	\$ 15.80		
Granted	1,325,000	\$ 25.99		
Exercised	(2,807,656)	\$ 13.43		
Forfeited	(996,442)	\$ 30.98		
Outstanding at December 31, 2006	<u>5,657,656</u>	<u>\$ 16.69</u>	<u>4.1</u>	<u>\$ 79,749</u>
Exercisable at December 31, 2006	<u>1,720,612</u>	<u>\$ 11.20</u>	<u>3.1</u>	<u>\$ 33,685</u>
Vested and expected to vest at December 31, 2006	<u>5,302,490</u>	<u>\$ 16.49</u>	<u>4.1</u>	<u>\$ 75,786</u>

The weighted-average grant-date fair value of options granted during years ended December 31, 2004, 2005 and 2006 was \$ 3.57, \$ 6.73 and \$ 9.20, respectively. The total intrinsic value of options exercised during the years ended December 31, 2006 was \$ 41,249.

As of December 31, 2006, there was approximately \$ 13,981 of total unrecognized compensation costs related to stock-based compensation arrangements granted under the Company's stock option plan. The cost is expected to be recognized over a weighted average period of 1.55 years.

The options outstanding under the Company's Stock Option Plans as of December 31, 2006 have been separated into ranges of exercise price as follows:

Ranges of exercise price \$	Options outstanding as of December 31, 2006	Weighted average remaining contractual life (Years)	Weighted average exercise price \$	Options exercisable as of December 31, 2006	Weighted Average Exercise price of Options Exercisable \$
3.915-5.57	162,920	1.81	5.01	162,920	5.01
6.00-8.27	377,890	0.83	6.67	374,140	6.66
9.66-14.03	1,489,757	3.59	10.62	608,413	10.26
15.165-22.75	2,312,889	4.55	17.77	575,139	16.91
24.36-31.27	1,314,200	5.38	25.99	-	-
	<u>5,657,656</u>			<u>1,720,612</u>	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The pro forma table below illustrates the effect on net income and basic and diluted net income per share for the years ended December 31, 2004 and 2005, if the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company's stock option plans in all periods presented prior to the adoption of SFAS 123(R). For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes-Merton option pricing formula with the following weighted-average assumptions:

	Year ended December 31,	
	2004	2005
Risk free interest rate	2.7%	4.1%
Dividend yield	0%	0%
Volatility factor	0.457	0.431
Expected life of the options	3	3.83
	Year ended December 31,	
	2004	2005
Net income as reported	\$ 24,555	\$ 36,569
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(7,182)</u>	<u>(9,382)</u>
Pro forma net income	<u>\$ 17,373</u>	<u>\$ 27,187</u>
Basic net earnings per share as reported	<u>\$ 0.70</u>	<u>\$ 0.95</u>
Diluted net earnings per share as reported	<u>\$ 0.66</u>	<u>\$ 0.89</u>
Pro forma basic net earnings per share	<u>\$ 0.49</u>	<u>\$ 0.71</u>
Pro forma diluted net earnings per share	<u>\$ 0.46</u>	<u>\$ 0.66</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Fair value of financial instruments:

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

The carrying amount reported in the balance sheet for cash and cash equivalents, trade receivables and trade payables approximates their fair value due to the short-term maturities of such instruments.

The fair value for marketable securities is based on quoted market prices and does not differ significantly from the carrying amount (see Note 3).

v. Legal contingencies:

The Company is currently involved in various claims and legal proceedings. The Company reviews the status of each matter and assesses its potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, the Company accrues a liability for the estimated loss.

w. Advertising expenses:

Advertising expenses are charged to expense as incurred. Advertising expenses for the years 2004, 2005 and 2006 were \$ 2,621, \$ 3,222 and \$ 5,155, respectively.

x. Derivatives and hedging activities:

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" requires the Company to recognize all of its derivative instruments as either assets or liabilities on the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the line item associated with the hedged item in earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income and reclassified into earnings in the line item associated with the hedged transaction in the period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in financial income/expense in the period of change.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- y. Recently issued accounting pronouncements:

In June 2006, the Financial Accounting Standard Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from Financial Accounting Standards Board Statement No. 5, "Accounting for Contingencies." FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). FIN 48 applies to all tax positions related to income taxes subject to SFAS No. 109, "Accounting for Income Taxes." This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. As a result of the implementation of FIN 48, the Company increased its retained earnings as of January 1, 2007 by approximately \$ 800.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Management believes this standard will not have a material effect on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 no later than January 1, 2008. The Company has not yet determined the effect that the adoption of SFAS No. 159 will have on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- MARKETABLE SECURITIES

- a. The following table summarizes amortized costs, gross unrealized gains and losses and estimated fair values of held-to-maturity marketable securities as of December 31, 2005 and 2006:

	<u>Amortized cost</u>		<u>Gross unrealized gains</u>		<u>Gross unrealized losses</u>		<u>Estimated fair value</u>	
	<u>December 31,</u>		<u>December 31,</u>		<u>December 31,</u>		<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>
U.S. corporate debentures	\$ 71,043	\$ 102,597	\$ -	45	\$ (1,172)	(970)	\$ 69,871	101,672
U.S Government debentures	73,278	93,820	4	-	(1,424)	(775)	71,858	93,045
Structured notes	12,180	9,680	-	-	-	(123)	12,180	9,557
	<u>\$156,501</u>	<u>\$ 206,097</u>	<u>\$ 4</u>	<u>45</u>	<u>\$ (2,596)</u>	<u>\$ (1,868)</u>	<u>\$153,909</u>	<u>\$ 204,274</u>

The following table shows the gross unrealized losses and fair value of Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2006:

	<u>December 31, 2006</u>					
	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
U.S. corporate debentures	\$ 37,101	\$ (188)	\$ 52,722	\$ (782)	\$ 89,823	\$ (970)
U.S Government debentures	\$ 40,047	\$ (140)	\$ 52,997	\$ (635)	\$ 93,044	\$ (775)
Structured notes	-	-	\$ 4,877	\$ (123)	\$ 4,877	\$ (123)
	<u>\$ 77,148</u>	<u>\$ (328)</u>	<u>\$ 110,596</u>	<u>\$ (1,540)</u>	<u>\$ 187,744</u>	<u>\$ (1,868)</u>

The unrealized losses in the Company's investments in held-to-maturity marketable securities were caused by interest rate increases. The contractual cash flows of these investments are either guaranteed by the U.S. government or an agency of the U.S. government or were issued by highly rated corporations. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Based on the immaterial severity of the impairments and the ability and intent of the Company to hold these investments to maturity, the bonds were not considered to be other than temporarily impaired at December 31, 2006.

As of December 31, 2005 and 2006, all the Company's U.S. corporate debentures, U.S. government debentures and structured notes were classified as held-to-maturity.

In 2004 the Company sold debt securities, which were classified as held-to-maturity, due to a rating decrease, in consideration of \$ 911. As a result of the sale, the Company recorded a loss of \$ 14. In 2005 and 2006, the Company did not sell any securities prior to their maturity and accordingly, did not realize any gains or losses on held-to-maturity securities in that year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- MARKETABLE SECURITIES (Cont.)

During 2005 and 2006, held-to-maturity marketable securities in the amount of \$ 9,630 and \$ 3,000, respectively, were called by the issuers prior to maturity.

The scheduled maturities of held-to-maturity marketable securities at December 31, 2006 are as follows:

	<u>Amortized cost</u>	<u>Estimated fair value</u>
Held-to-maturity:		
Due within one year	\$ 70,287	\$ 69,792
Due after one year through five years	128,294	127,046
Due after five years through ten years	<u>7,516</u>	<u>7,436</u>
	<u>\$ 206,097</u>	<u>\$ 204,274</u>

- b. Auction rate securities in the amount of \$ 22,572 as of December 31, 2006, were classified as available-for-sale marketable securities and were presented as short-term marketable securities. As of December 31, 2005, no auction rate securities were held by the Company. The scheduled maturities of available-for-sale marketable securities at December 31, 2006 are above 10 years.

NOTE 4:- SHORT-TERM OTHER RECEIVABLES AND PREPAID EXPENSES

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
Government authorities	\$ 1,959	\$ 2,355
Interest receivable	1,202	2,113
Prepaid expenses	4,062	4,771
Assets of discontinued operation	646	646
Other	<u>1,675</u>	<u>1,514</u>
	<u>\$ 9,544</u>	<u>\$ 11,399</u>

NOTE 5:- INVENTORIES

Raw materials	\$ 1,022	\$ 2,457
Work-in-progress	29	56
Finished goods	<u>22,121</u>	<u>16,106</u>
	<u>\$ 23,172</u>	<u>\$ 18,619</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2005	2006
Cost:		
Computers and peripheral equipment	\$ 55,260	\$ 61,941
Office furniture and equipment	13,839	15,154
Leasehold improvements	3,986	4,443
Motor Vehicles	23	3
	<u>73,108</u>	<u>81,541</u>
Accumulated depreciation:		
Computers and peripheral equipment	47,439	52,382
Office furniture and equipment	8,038	10,077
Leasehold improvements	2,739	3,267
Motor Vehicles	4	2
	<u>58,220</u>	<u>65,728</u>
Depreciated cost	<u>\$ 14,888</u>	<u>\$ 15,813</u>

Depreciation expense totaled \$ 8,603, \$ 7,941 and \$ 8,244 for the years ended December 31, 2004, 2005 and 2006, respectively.

NOTE 7:- OTHER INTANGIBLE ASSETS, NET

a. Other intangible assets:

	December 31,	
	2005	2006
Original amounts:		
Capitalized software development costs	\$ 9,063	\$ 5,037
Core technology	9,319	60,910
Trademarks	1,440	6,642
Customer relationships and distribution network	17,517	60,533
Maintenance contracts	534	582
	<u>37,873</u>	<u>133,704</u>
Accumulated amortization:		
Capitalized software development costs	6,266	2,500
Core technology	5,037	11,869
Trademarks	982	1,854
Customer relationships and distribution network	1,064	5,717
Maintenance contracts	534	582
	<u>13,883</u>	<u>22,522</u>
Other intangible assets, net	<u>\$ 23,990</u>	<u>\$ 111,182</u>

b. Amortization expense amounted to \$ 5,190, \$ 5,211 and \$ 13,675 for the years ended December 31, 2004, 2005 and 2006, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 7:- OTHER INTANGIBLE ASSETS, NET (Cont.)**

- c. Estimated amortization expense for the years ended (excluding amortization of capitalized software development costs):

<u>December 31,</u>	
2007	16,541
2008	15,775
2009	15,166
2010	14,712
2011	11,393
Thereafter	<u>35,058</u>
	<u><u>108,645</u></u>

NOTE 8:- GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2005 and 2006 are as follows:

Balance as of January 1, 2005	\$ 25,745
Adjustment to goodwill in respect of settlement	(1,191)
Additions in respect of the acquisitions of CRS and Hannamax	26,470
Foreign currency translation adjustments	<u>(1,171)</u>
Balance as of December 31, 2005	49,853
Adjustment to goodwill in respect of settlement	1,000
Additions in respect of the acquisitions of Hannamax, FAST, Performix and IEX	166,734
Foreign currency translation adjustments	<u>2,843</u>
Balance as of December 31, 2006	<u><u>\$ 220,430</u></u>

NOTE 9:- ACCRUED EXPENSES AND OTHER LIABILITIES

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
Employees and payroll accruals	\$ 20,692	\$ 26,877
Accrued expenses	26,868	45,234
Deferred revenues	44,769	60,684
Other	<u>8,215</u>	<u>14,195</u>
	<u><u>\$ 100,544</u></u>	<u><u>\$ 146,990</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 10:- DERIVATIVE INSTRUMENTS**

To protect against changes in the value of forecasted foreign currency transactions and balances, the Company has instituted a foreign-currency hedging program. The Company hedges portions of its forecasted cash flows and balances denominated in foreign currencies with forward contracts and option strategies (together: "derivative instruments").

The Company entered into derivative instrument arrangements to hedge a portion of anticipated New Israeli Shekel ("NIS") payroll payments. These derivative instruments are designated as cash flows hedges, as defined by SFAS No. 133, as amended, and are all highly effective as hedges of these expenses when the salary is recorded. The effective portion of the derivative instruments is included in payroll expenses in the statements of income.

In addition, the Company entered into derivative instruments to hedge certain trade receivables, trade payable payments, expected payments under fixed price contracts denominated in foreign currency, liabilities to employees and other long-term liability. The purpose of the Company's foreign currency hedging activities is to protect the Company from changes in the foreign currency exchange rate to the dollar.

At December 31, 2006, the Company expects to reclassify \$72 of net gains on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company leases office space, office equipment and various motor vehicles under operating leases.

1. The Company's office space and office equipment are rented under several operating leases.

Future minimum lease commitments under non-cancelable operating leases for the years ended December 31, are as follows:

2007	\$ 9,003
2008	3,112
2009	2,566
2010	1,843
2011 and thereafter	<u>2,893</u>
	<u>\$ 19,417</u>

Rent expenses for the years ended December 31, 2004, 2005 and 2006 were approximately \$ 6,107, \$ 6,317 and \$ 8,668, respectively.

2. The Company leases its motor vehicles under cancelable operating lease agreements. The minimum payment under these operating leases, upon cancellation of these lease agreements was \$ 933 as of December 31, 2006.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Lease expenses of vehicles for the years ended December 31, 2004, 2005 and 2006 were \$ 2,396, \$ 2,552 and \$ 2,865, respectively.

b. Other commitments:

The Company is obligated under certain agreements with its suppliers to purchase goods and under an agreement with its manufacturing subcontractor to purchase projected inventory and excess inventory. Non cancelable obligations, net of provisions, as of December 31, 2006, were approximately \$ 6,700. These obligations will be fulfilled during 2007.

c. Legal proceedings:

1. On October 19, 2004, CipherActive filed an action against the Company in the District Court of Tel Aviv, State of Israel. In this lawsuit, CipherActive claims that under a development agreement with the Company, it is entitled to receive license fees in respect of certain software that it allegedly developed for the Company and which has been embedded in one of the Company's products. CipherActive claims that it is entitled to license fees in the amount of \$ 600 in addition to the amount of \$ 100 already paid to CipherActive by the Company in respect of such license fees. In the Company's statement of defense it claims that the software developed by CipherActive under the agreement has not been successful in the market, is no longer embedded in the Company's product and, therefore, CipherActive is not entitled to any additional license fees. On February 1, 2007, a preliminary hearing took place, during which the Company suggested that the parties submit the dispute to mediation. Although the court approved the mediation, the parties failed to find an appropriate mediator. In a pretrial hearing that took place on May 27, 2007, the court accepted CipherActive's request to allow additional time for negotiations between the parties. An additional pretrial hearing has been set for July 8, 2007.
2. On July 20, 2004, STS Software System Ltd. ("STS"), a wholly owned subsidiary of the Company, brought a lawsuit against Witness Systems, Inc. asserting that Witness Systems is infringing three U.S. patents of STS relating to Voice over Internet Protocol ("VoIP"). STS claims that Witness Systems infringes the VoIP patents by marketing and selling products that incorporate methods of detecting, monitoring and recording information – all fully protected by the patents. STS is seeking a permanent injunction to prevent Witness Systems from making, using, offering to sell or selling any product in the United States that infringes these patents. In response, Witness Systems is asserting that the patents are invalid and not infringed. With the Company's consent, STS moved the court on January 3, 2007 to join the Company as a plaintiff in the litigation. The case, which is pending in the U.S. District Court for the Northern District of Georgia is in discovery.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

On August 30, 2004, Witness Systems filed a lawsuit in the United States District Court for the Northern District of Georgia against NICE Systems Inc., a wholly owned subsidiary of the Company. Witness Systems is alleging infringement of two U.S. patents entitled "Method and Apparatus for Simultaneously Monitoring Computer User Screen and Telephone Activity from a Remote Location" and is seeking unspecified damages and injunctive relief. On February 24, 2005, Witness Systems filed a similar action in the Northern District of Georgia against the Company alleging infringement of the same two patents. The two actions were consolidated in April 2005. The Company has denied infringing these patents and is vigorously defending against Witness Systems' claims. In addition, the Company has asserted its right to be indemnified for losses arising out of the claims of infringement in this litigation pursuant to an agreement between the Company and Netopia, Inc., our vendor. The case is currently in discovery and no trial date has been set.

On January 19, 2006, Witness Systems filed a new patent infringement action in the United States District Court for the Northern District of Georgia against the Company and its wholly owned subsidiary, NICE Systems Inc., alleging infringement of a U.S. patent relating to technology to extract particular information from recorded telephone conversations. This technology is used as an option with a Company product called NicePerform. Witness Systems is requesting unspecified damages and a permanent injunction to prevent any sale of allegedly infringing products. The Company has denied all material allegations and is asserting a number of defenses. The Company believes that the claims are without merit and intends to vigorously defend against them. The case is currently in discovery.

On May 10, 2006, the Company and its wholly owned subsidiary, NICE Systems, Inc. filed a new lawsuit against Witness Systems, Inc. in the United States District Court for District of Delaware claiming that Witness Systems is infringing ten U.S. patents. These patents cover various aspects of recording customer interaction communications and traditional logging including event triggered call and screen recording, "cradle-to-grave" recording of customer calls, traditional TDM loggers, off-site storage of calls, and multi-stage telephone data logging. In this lawsuit, the Company claims that Witness Systems infringes the Company's patents by marketing and selling products that use methods, products and systems which the Company believes are protected by Company's patents. The Witness products the Company has accused of infringing its patents include Impact 360®, ContactStore®, eQuality ContactStore®, ContactStore for Communication Manager®, eQuality ContactStore for Communication Manager® and Eyretel's MediaStore®. The Company is seeking a permanent injunction to prevent Witness Systems from making, using, or offering to sell or selling any product in the United States which infringes these patents. In addition, the Company is seeking damages for Witness Systems' past willful infringement of these patents. The case is in discovery and a trial is scheduled to begin on January 15, 2008.

On December 28, 2006, the Company and its wholly owned subsidiary, Nice Systems, Inc., filed an action against Witness Systems, Inc., seeking a declaration from the court that a certain patent, which is closely related to the patent aforementioned with respect to the lawsuit filed by Witness Systems on January 19, 2006, is invalid and not infringed. The case is in its very early stages and discovery has not yet begun.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

3. The Company is currently in dispute with Origin Data Realisation Limited (“Origin”) relating to the terms of a license of software and other matters. The dispute was submitted to mediation and a settlement dialogue is ongoing. To date, no formal legal proceedings have been instituted by either side.
4. On July 27, 2004, Dictaphone Corp. filed an action against VoicePrint in the United States District Court for the Central District of California asserting the infringement by VoicePrint of two U.S patents, which the Company subsequently acquired from Dictaphone. This lawsuit has been settled in principle. The documentation for this settlement continues to be negotiated, and is expected to be completed and signed shortly.
5. In December 2006, Calyon Corporate and Investment Bank (“Calyon”) filed a suit against the Company in the District Court of Tel Aviv, demanding repayment of \$ 648 plus accrued interest, in the total amount of \$ 740. The Company deducted this amount in January 2004 from a payment transferred from an account of Thales maintained with Calyon to the Company’s account, at the instruction of Thales, in connection with the acquisition of Thales Contact Solutions (“TCS”) from Thales. The Company had notified TCS in 2004 that it had setoff such amount with respect to an overdue payment by TCS to the Company. The Company believes that it had the legal right to make the deduction at the time and therefore intends to vigorously defend against such claim. This lawsuit is in its initial stages.
6. On March 9, 2007, Formatest AG filed a claim against NICE Switzerland AG, a wholly owned subsidiary of the Company, in the Cantonal Court of Zug, Switzerland. The claim is in the amount of approximately \$ 1,600 (EUR 1,187,793), plus interest at 5% per annum, and is made in connection with an agreement dated December 10, 2004 between FAST Video Security AG (now NICE Switzerland AG) and Formatest AG. The Company expects to be entitled to recover a substantial part of any liability owed by NICE Switzerland AG to Formatest AG under the terms of indemnification provision contained in the sale and purchase agreement relating to the acquisition of the shares in FAST Video Security AG, although the parties to the sale and purchase agreement who are obliged to pay such indemnification contest any such liability. The Company and Formatest AG have started to discuss a potential settlement of the dispute.

NOTE 12:- CREDIT LINES

As of December 31, 2006, the Company had authorized credit lines from banks in the amount of approximately \$ 260,000. When utilized, the credit lines will be denominated in dollars and will bear interest at the rate of up to LIBOR + 0.45 %. An amount of approximately \$ 211,000 out of the total credit lines is secured by the Company’s cash and cash equivalents and marketable securities. As of December 31, 2006, \$ 6,200 of the \$ 260,000 referred to above was used for bank guarantees.

The company has no financial covenants to secure the above credit lines.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME

a. Israeli taxation:

1. Corporate tax rates in Israel:

Taxable income of Israeli companies is subject to tax at the rate of 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

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

The Law empowers the Israeli Investment Center to grant Approved Enterprise status to capital investments in production facilities that meet certain relevant criteria ("Approved Enterprise"). In general, such capital investments will receive Approved Enterprise status if the enterprise is expected to contribute to the development of the productive capacity of the economy, absorption of immigrants, creation of employment opportunities, or improvement in the balance of payments.

The tax benefits derived from any such Approved Enterprise relate only to taxable income attributable to the specific program of investment to which the status was granted. To the extent that NICE has been granted Approved Enterprise status and operates under more than one approval, or that its capital investments are only partly approved, its effective corporate tax rate will be the result of a weighted combination of the various rates applicable.

Certain production facilities of NICE have been granted the status of an Approved Enterprise under the Law, in four separate investment programs. For all such Approved Enterprises, the Company elected to apply for alternative tax benefits ("Alternative Package"), waiving government grants in return for a tax exemption.

Income derived from the first and second program was tax-exempt for a period of four years, commencing 1999 and 1997, respectively, and is taxed at the reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership in each taxable year) for an additional period of six years. Income derived from the third and fourth programs are tax-exempt for a period of two years, commencing 2005, and will be taxed at the reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership in each taxable year) for an additional period of eight years.

The above mentioned tax benefits are scheduled to expire by 2014 in a gradual manner.

In the event of distribution of dividends from the said tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's income. The tax-exempt income attributable to the "Approved Enterprise" programs mentioned above can be distributed to shareholders without subjecting NICE to taxes only upon the complete liquidation of NICE.

The duration of tax benefits, for each of the Programs is subject to limitations of the earlier of 12 years from completion of the investment or commencement of production, or 14 years from receipt of approval, as an Approved Enterprise under the Law.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME (Cont.)

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Law and regulations published thereunder. Should NICE fail to meet such requirements in the future, income attributable to its Approved Enterprise programs could be subject to the statutory Israeli corporate tax rate and the Company could be required to refund a portion of the tax benefits already received, with respect to such programs. As of December 31, 2006, management believes that NICE is in compliance with all the conditions required by the Law.

On April 1, 2005, an amendment to the Law came into effect ("the Amendment") and has significantly changed the provisions of the Law. The 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 "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise), such as a provision 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 are no longer required for Investment Center approval in order to qualify for tax benefits. The period of tax benefits for a new "Privileged Enterprise" commences in the "Year of Commencement". This year is the later of: (1) the year in which taxable income is first generated by the company, or (2) a year selected by the company for commencement, on the condition that the company meets certain provisions provided by the Law ("Year of Election").

If a company requested the "Alternative Package" of benefits for an Approved Enterprise under the old law before the 2005 amendment, it is precluded from filing a Year of Election notice for a "Privileged Enterprise" for three years after the year in which the Approved Enterprise was activated.

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

The Company determined 2006 as the Year of Election for the purposes of commencing the Privileged Enterprise first program benefits under the amended law. This plan brings the total number of Approved Enterprise investment programs to five.

As a result of the amendment, tax-exempt income generated under the provisions of the amended law, will subject the Company to taxes upon dividend distribution or complete liquidation.

The Company does not intend to distribute any amounts of its undistributed tax exempt income as dividends as it intends to reinvest its tax-exempt income within the Company. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Enterprise programs as the undistributed tax exempt income is essentially permanent in duration.

Dividends distributed by an Approved Enterprise and "Privileged Enterprise" will be subject to withholding tax of 15%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME (Cont.)

Out of the Company's retained earnings as of December 31, 2006 approximately \$ 49,000 are tax-exempt attributable to its various Approved Enterprise programs. If such tax exempt income is distributed (other than in respect of the first four programs upon the complete liquidation of the Company), it would be taxed at the reduced corporate tax rate applicable to such profits (between 15%-25%) and an income tax liability of up to approximately \$ 10,000 would be incurred as of December 31, 2006.

Income from sources other than the Approved Enterprise is subject to tax at regular Israeli corporate tax rate.

3. Tax benefits under the Israeli Law for the Encouragement of Industry (Taxation), 1969:

NICE is an "Industrial Company" as defined and, as such, is entitled to certain tax benefits including accelerated depreciation, deduction of public offering expenses in three equal annual installments and amortization of other intangible property rights for tax purposes.

b. Income taxes on non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective country of residence. Neither Israeli income taxes, foreign withholding taxes nor deferred income taxes were provided in relation to undistributed earnings of the Company's foreign subsidiaries. This is because the Company intends to permanently reinvest undistributed earnings in the foreign subsidiaries in which those earnings arose. If these earnings were distributed to Israel in the form of dividends or otherwise, the Company would be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes.

c. Net operating loss carryforward:

As of December 31, 2006, the Company had carry forward tax losses totaling approximately \$ 51,000 which can be carried forward and offset against taxable income with expiration dates ranging from 2007 and onwards. Approximately \$ 24,000 of these carry forward tax losses have no expiration date. The balance expires between 2007 and 2026.

Utilization of U.S. net operating losses may be subject to substantial annual limitation 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 increasing taxes before utilization.

Of the Company's total carry forward tax losses, approximately \$ 25,000 were inherited at the time of the acquisition of certain of our subsidiaries. A valuation allowance of \$ 2,800 has been applied thereto. Any subsequent reduction of this valuation allowance and the recognition of the associated tax benefit will be applied to reduce goodwill.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 13:- TAXES ON INCOME (Cont.)**

d. Deferred tax assets and liabilities:

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

	December 31,	
	2005	2006
Deferred tax assets:		
Net operating losses carry forward	\$ 5,961	\$ 11,412
Acquired intangibles	6,802	6,881
Other	5,833	5,679
	<hr/>	<hr/>
Deferred tax assets before valuation allowance	18,596	23,972
Valuation allowance	(10,260)	(6,577)
	<hr/>	<hr/>
Deferred tax assets	8,336	17,395
	<hr/>	<hr/>
Deferred tax liabilities:		
Acquired intangibles	(2,493)	(33,130)
	<hr/>	<hr/>
Deferred tax assets (liabilities), net	<u>\$ 5,843</u>	<u>\$ (15,735)</u>

The Company has provided valuation allowances in respect of certain deferred tax assets resulting from tax loss carry forwards and other reserves and allowances due to uncertainty concerning realization of these deferred tax assets.

Decrease in valuation allowance in 2006 amounted to \$ 3,683 resulted from decrease of \$ 5,753 related to business combinations, and increase of \$ 2,070 related to operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 13:- TAXES ON INCOME (Cont.)**

- e. A reconciliation of the Company's effective tax rate to the statutory tax rate in Israel is as follows:

	Year ended December 31,		
	2004	2005	2006
Income before taxes on income, as reported in the consolidated statements of income	\$ 23,638	\$ 37,471	\$ 30,992
Statutory tax rate in Israel	35%	34%	31%
Approved and Privileged enterprise benefits *)	-	(1.9%)	(14.6%)
Changes in valuation allowance	(27.2%)	(30.8%)	3.8%
Foreign earnings taxed at different rates	-	-	(7.4%)
Accounting for acquired In-process research and development	-	-	14.6%
Other	2.0%	1.1%	0.3%
Effective tax rate	9.8%	2.4%	27.7%

*) Net earnings per ordinary share - amounts of the benefit resulting from the "Approved and Privileged Enterprise" status

Basic	\$ -	\$ 0.02	\$ 0.09
Diluted	\$ -	\$ 0.01	\$ 0.09

- f. Income before taxes on income is comprised as follows:

	Year ended December 31,		
	2004	2005	2006
Domestic	\$ 15,367	\$ 30,681	\$ 33,629
Foreign *)	8,271	6,790	(2,637)
	\$ 23,638	\$ 37,471	\$ 30,992

*) The loss before taxes in 2006 arose as a result of write off of acquired In Process Research and Development of approximately \$ 13,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME (Cont.)

- g. Taxes on income are comprised as follows:

	Year ended December 31,		
	2004	2005	2006
Current	\$ 2,319	\$ 5,743	\$ 6,403
Deferred	-	(4,841)	\$ 2,187
	<u>\$ 2,319</u>	<u>\$ 902</u>	<u>\$ 8,591</u>
Domestic	\$ 1,836	\$ 1,553	\$ 5,892
Foreign	483	(651)	\$ 2,698
	<u>\$ 2,319</u>	<u>\$ 902</u>	<u>\$ 8,591</u>

NOTE 14:- SHAREHOLDERS' EQUITY

- a. The Ordinary shares of the Company are traded on the Tel Aviv Stock Exchange and its ADS's are traded on NASDAQ.

In December 2005 the Company effected a secondary public offering of its ADS's on NASDAQ. The Company issued 9,200,000 shares at a price of \$ 23.13 per share before underwriting and issuance expenses. Total net proceeds from the issuance amounted to approximately \$ 201,724.

- b. Share option plans:

In 1995, the Company adopted an employee share option plan ("the 1995 Option Plan"). Under the 1995 option plan, employees and officers of the Company may be granted options to acquire Ordinary shares. The options to acquire Ordinary shares, which may only be determined by the Board of Directors of the Company, are granted at an exercise price, subject to certain exceptions, of not less than the fair market value of the Ordinary shares on the grant date. 16,691,132 options of the 1995 Option Plan were granted.

The options generally vest gradually over a four-year period from the date of grant. As of February 15, 2000, the Board of Directors of the Company adopted a resolution amending the exercise terms for any option granted subsequent to February 15, 2000 under the 1995 Option Plan whereby 25% of the stock options granted become exercisable on the first anniversary of the date of grant and 6.25% become exercisable once every quarter during the subsequent three years. The options expire no later than 6 years from the date of grant.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

In 2001, the Company adopted the 2001 Stock Option Plan ("the 2001 Option Plan"). The options to acquire Ordinary shares, which may only be determined by the Board of Directors of the Company, are granted at an exercise price, of not less than the fair market value of the Ordinary shares on the grant date. 5,919,500 options of the 2001 Option Plan were granted. Unless otherwise determined by the Company's Board of Directors as of the date of grant, the stock options expire six years after the date of grant.

In 2003, the Company adopted the 2003 Stock Option Plan ("the 2003 Option Plan"). Under the 2003 option plan, employees and officers of the Company may be granted options to acquire Ordinary shares. The options to acquire Ordinary shares, which may only be determined by the Board of Directors of the Company, are granted at an exercise price, subject to certain exceptions, of not less than the fair market value of the Ordinary shares on the grant date. 6,739,000 options of the 2003 Option Plan were granted. Unless otherwise determined by the Company's Board of Directors as of the date of grant, the stock options expire six years after the date of grant.

On December 21, 2006, the shareholders of the Company approved an increase to the pool of shares reserved under the Company's 2003 employee stock option plan by an additional amount of 1,300,000 Ordinary shares.

c. Employee Stock Purchase Plan ("ESPP"):

In February 1999, the Company's Board of Directors adopted the Employee Stock Purchase Plan ("the Purchase Plan"). Eligible employees can have up to 10% of their earnings withheld, up to certain maximums, to be used to purchase Ordinary shares. Up to 2006, the price of Ordinary shares purchased under the Purchase Plan was 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. On December 2005, the Board of Directors amended the plan effective January 1, 2006, so that the price of Ordinary shares purchased under the Purchase Plan will equal to 95% of Ordinary share price fair market value of the Ordinary shares on the semi-annual purchase date.

During 2004, 2005 and 2006, employees purchased 279,826, 334,090 and 8,570 shares at average prices of \$ 8.10, \$ 12.94 and \$ 26.73 per share, respectively.

d. Stock split:

On May 17, 2006, the Company affected a two-for-one stock split on its Ordinary shares which was affected in the form of a 100% stock dividend. Shareholders of record at the close of business on May 30, 2006, the record date, received one additional Ordinary Share/ADR for each Ordinary Share/ADR held. All Ordinary share options and per share amounts have been adjusted to give retroactive effect to the stock split for all periods presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

e. Dividends:

Dividends, if any, will be paid in NIS. Dividends paid to shareholders outside Israel may be converted to dollars on the basis of the exchange rate prevailing at the date of the conversion. The Company does not intend to pay cash dividends in the foreseeable future.

f. Increase in authorized share capital:

On December 21, 2006, the shareholders of the Company approved an Amendment to the Company's Memorandum and Articles of Association in order to increase the authorized share capital from 75,000,000 to 125,000,000 Ordinary shares.

NOTE 15:- MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION

a. Geographical segments:

In 2006, following the expansion of the operations in certain regions, the Company determined that the various regions are considered reportable segments and provided summarized financial information as set forth below.

Revenues in each geographical segment represent revenues originating from that reportable segment.

	Year ended December 31, 2006				
	Americas	EMEA*)	APAC**)	Not allocated	Total
Revenues	\$ 241,307	\$ 112,541	\$ 55,796	\$ -	\$ 409,644
Gross profit (loss)	\$ 141,797	\$ 70,028	\$ 37,097	\$ (13,492)	\$ 235,430
Operating expenses	\$ 59,766	\$ 30,326	\$ 10,169	\$ 118,072	\$ 218,333
Operating income (loss)	\$ 82,031	\$ 39,702	\$ 26,928	\$ (131,564)	\$ 17,097
	Year ended December 31, 2005				
	Americas	EMEA*)	APAC**)	Not allocated	Total
Revenues	\$ 163,286	\$ 99,348	\$ 48,476	\$ -	\$ 311,110
Gross profit (loss)	\$ 92,885	\$ 61,184	\$ 33,421	\$ (12,606)	\$ 174,884
Operating expenses	\$ 44,145	\$ 25,448	\$ 6,721	\$ 66,484	\$ 142,798
Operating income (loss)	\$ 48,740	\$ 35,735	\$ 26,700	\$ (79,089)	\$ 32,086

*) Includes Europe, the Middle East (including Israel) and Africa

***) Includes Asia Pacific

NICE SYSTEMS LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION (Cont.)

The following presents long-lived assets of December 31, 2006 and December 31, 2005:

	Year ended December 31,	
	2005	2006
Americas	\$ 41,479	\$ 261,408
EMEA	44,991	82,966
APAC	2,261	3,051
	<u>\$ 88,731</u>	<u>\$ 347,425</u>

b. Product lines:

Total revenues from external customers on the basis of the Company's product lines are as follows:

	Year ended December 31,		
	2004	2005	2006
Enterprise Interaction Solutions	\$ 194,111	\$ 237,353	\$ 300,920
Public Safety and Security sector	58,532	73,757	108,724
	<u>\$ 252,643</u>	<u>\$ 311,110</u>	<u>\$ 409,644</u>

c. Major customer data as a percentage of total revenues:

Customer A	<u>19%</u>	<u>21%</u>	<u>16%</u>
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NOTE 16:- SELECTED STATEMENTS OF INCOME DATA

a. Research and development, net:

	Year ended December 31,		
	2004	2005	2006
Total costs	\$ 27,512	\$ 33,404	\$ 47,963
Less - grants and participations	(1,341)	(1,702)	(1,858)
Less - capitalization of software development costs	(1,305)	(806)	(1,225)
	<u>\$ 24,866</u>	<u>\$ 30,896</u>	<u>\$ 44,880</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 16:- SELECTED STATEMENTS OF INCOME DATA (Cont.)

b. Financial income, net:

Financial income:	Year ended December 31,		
	2004	2005	2006
Interest and amortization/accretion of premium/discount of marketable securities	\$ 2,349	\$ 4,073	\$ 6,848
Interest	1,425	1,979	7,061
Foreign currency translation	1,078	258	1,434
	<u>4,852</u>	<u>6,310</u>	<u>15,343</u>
Financial expenses:			
Foreign currency translation	(894)	(542)	(1,455)
Other	(402)	(370)	(616)
	<u>(1,296)</u>	<u>(912)</u>	<u>(2,071)</u>
	<u>\$ 3,556</u>	<u>\$ 5,398</u>	<u>\$ 13,272</u>

c. Net earnings per share:

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

1. Numerator:

Numerator for basic and diluted net earnings per share -	Year ended December 31,		
	2004	2005	2006
Net income from continuing operations	\$ 21,319	\$ 36,569	\$ 22,401
Net income from discontinued operation	3,236	-	-
Net income available to Ordinary shareholders	<u>\$ 24,555</u>	<u>\$ 36,569</u>	<u>\$ 22,401</u>

2. Denominator (in thousands):

Denominator for basic net earnings per share - Weighted average number of shares	34,994	38,242	49,572
Effect of dilutive securities:			
Add - Employee stock options	2,396	3,042	2,429
Add - ESPP	16	8	1
Denominator for diluted net earnings per share - adjusted weighted average shares	<u>37,406</u>	<u>41,292</u>	<u>52,002</u>