



NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2007

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, 2006 and 2007, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. 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, 2006 and 2007, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2007, 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 Company and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 14, 2008 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
April 14, 2008

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

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit 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 Actimize Ltd. ("Actimize") because it was acquired during 2007. Actimize is included in the 2007 consolidated financial statements of the Company since August 30, 2007 and constituted approximately 26% of total assets as of December 31, 2007 and 2% 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 Actimize.



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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Nice and subsidiaries as of December 31, 2006 and 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007 and our report dated April 14, 2008 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
April 14, 2008.

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

NICE SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2006	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 67,365	\$ 116,619
Short-term bank deposits	130	39,233
Marketable securities	92,859	84,089
Trade receivables (net of allowance for doubtful accounts of \$ 1,951 and \$ 5,239 at December 31, 2006 and 2007, respectively)	81,312	101,977
Other receivables and prepaid expenses	11,399	20,749
Inventories	18,619	11,835
Deferred tax assets	9,951	8,258
<u>Total current assets</u>	<u>281,635</u>	<u>382,760</u>
LONG-TERM ASSETS:		
Marketable securities	135,810	158,260
Investment in affiliates	1,200	1,200
Severance pay fund	9,998	13,966
Other receivables and prepaid expenses	832	3,183
Deferred tax assets	7,444	8,739
Property and equipment, net	15,813	18,655
Other intangible assets, net	111,182	162,315
Goodwill	220,430	443,256
<u>Total long-term assets</u>	<u>502,709</u>	<u>809,574</u>
<u>Total assets</u>	<u>\$ 784,344</u>	<u>\$ 1,192,334</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 data)

	December 31,	
	2006	2007
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 22,845	\$ 21,792
Accrued expenses and other liabilities	146,990	208,085
<u>Total current liabilities</u>	<u>169,835</u>	<u>229,877</u>
LONG-TERM LIABILITIES:		
Accrued severance pay	11,743	16,431
Deferred tax liabilities	33,130	41,764
Other long-term liabilities	62	468
<u>Total long-term liabilities</u>	<u>44,935</u>	<u>58,663</u>
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital-		
Ordinary shares of NIS 1 par value:		
Authorized: 125,000,000 at December 31, 2006 and 2007; Issued and outstanding: 51,091,512 and 59,412,812 shares at December 31, 2006 and 2007, respectively;	12,754	14,801
Additional paid-in capital	522,866	811,250
Accumulated other comprehensive income	7,483	13,068
Retained earnings	26,471	64,675
<u>Total shareholders' equity</u>	<u>569,574</u>	<u>903,794</u>
<u>Total liabilities and shareholders' equity</u>	<u>\$ 784,344</u>	<u>\$ 1,192,334</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,		
	2005	2006	2007
Revenues:			
Products	\$ 206,355	\$ 261,098	\$ 316,888
Services	104,755	148,546	200,486
<u>Total revenues</u>	<u>311,110</u>	<u>409,644</u>	<u>517,374</u>
Cost of revenues:			
Products	67,543	84,675	89,373
Services	68,683	89,539	116,969
<u>Total cost of revenues</u>	<u>136,226</u>	<u>174,214</u>	<u>206,342</u>
Gross profit	<u>174,884</u>	<u>235,430</u>	<u>311,032</u>
Operating expenses:			
Research and development, net	30,896	44,880	59,632
Selling and marketing	72,829	95,190	120,592
General and administrative	37,742	60,463	85,089
Amortization of acquired intangibles	1,331	4,918	9,175
In process research and development write-off	-	12,882	3,710
<u>Total operating expenses</u>	<u>142,798</u>	<u>218,333</u>	<u>278,198</u>
Operating income	32,086	17,097	32,834
Financial income, net	5,398	13,272	14,824
Other income (expenses), net	(13)	623	(24)
Income before taxes on income	37,471	30,992	47,634
Taxes on income	902	8,591	10,254
Net income	<u>\$ 36,569</u>	<u>\$ 22,401</u>	<u>\$ 37,380</u>
Net earnings per share:			
Basic	<u>\$ 0.95</u>	<u>\$ 0.45</u>	<u>\$ 0.69</u>
Diluted	<u>\$ 0.89</u>	<u>\$ 0.43</u>	<u>\$ 0.67</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, 2005	\$ 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
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	12,754	522,866	7,483	26,471		569,574
Issuance of shares upon public offering, net	1,283	179,546	-	-		180,829
Issuance of shares of ESPP	4	495	-	-		499
Exercise of share options	393	19,406	-	-		19,799
Stock-based compensation	-	23,666	-	-		23,666
Tax benefit in respect of offering expenses	-	10	-	-		10
Excess tax benefit from share based payment arrangements	-	4,945	-	-		4,945
Issuance of shares and options for the acquisition of Actimize	365	60,272	-	-		60,637
Restricted shares vesting in respect of Actimize acquisition	2	44	-	-		46
FIN 48 opening balance adjustment	-	-	-	824		824
Comprehensive income:						
Foreign currency translation adjustments	-	-	5,175	-	5,175	5,175
Unrealized gains on derivative instruments, net	-	-	410	-	410	410
Net income	-	-	-	37,380	37,380	37,380
Total comprehensive income					<u>\$ 42,965</u>	
Balance as of December 31, 2007	<u>\$ 14,801</u>	<u>\$ 811,250</u>	<u>\$ 13,068</u>	<u>\$ 64,675</u>		<u>\$ 903,794</u>
Accumulated unrealized gains on derivative instruments			\$ 482			
Accumulated foreign currency translation adjustments			12,586			
Accumulated other comprehensive income as of December 31, 2007			<u>\$ 13,068</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,		
	2005	2006	2007
<u>Cash flows from operating activities:</u>			
Net income	\$ 36,569	\$ 22,401	\$ 37,380
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	13,152	21,919	30,926
Stock-based compensation	-	12,571	23,666
Excess tax benefit from share-based payments arrangements	-	(5,733)	(4,945)
Tax benefit from exercised options	1,501	-	-
In-process research and development write-off	-	12,882	3,710
Accrued severance pay, net	187	751	632
Amortization of premium (accretion of discount) and accrued interest on held-to-maturity marketable securities	812	278	5
Deferred taxes, net	(4,841)	(3,707)	(5,231)
Increase in trade receivables	(11,488)	(6,772)	(15,224)
Decrease (increase) in other receivables and prepaid expenses	566	(1,897)	(9,623)
Decrease (increase) in inventories	(3,930)	5,376	7,579
Increase (decrease) in trade payables	5,782	1,435	(2,982)
Increase in accrued expenses and other liabilities	27,339	27,991	51,933
Other	54	80	(58)
Net cash provided by operating activities from continuing operations	65,703	87,575	117,768
Net cash provided by operating activities from discontinued operation	-	-	476
Net cash provided by operating activities	65,703	87,575	118,244
<u>Cash flows from investing activities:</u>			
Purchase of property and equipment	(6,128)	(8,111)	(10,947)
Proceeds from sale of property and equipment	66	76	58
Investment in marketable securities	(218,472)	(217,655)	(208,590)
Proceeds from maturity of marketable securities	190,682	142,209	170,945
Proceeds from sale and call of held-to-maturity marketable securities	9,630	3,000	30,100
Investment in short-term bank deposits	(39)	(117)	(39,131)
Proceeds from short-term bank deposits	108	99	139

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
<u>Cash flows from investing activities (cont.):</u>			
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)	(500)
Payment for the acquisition of FAST (c)	-	(21,320)	(4,975)
Payment for the acquisition of Performix (d)	-	(13,800)	-
Payment for the acquisition of IEX (e)	-	(203,162)	(1,500)
Payment for the acquisition of Actimize (f)	-	-	(210,540)
Decrease in accrued acquisition costs	-	(15)	(83)
Proceeds in respect of TCS acquisition	2,531	-	-
Capitalization of software development costs	(806)	(1,225)	(962)
Deferred acquisition costs	(256)	-	-
Other	-	83	-
Net cash used in investing activities	<u>(64,297)</u>	<u>(318,438)</u>	<u>(275,986)</u>
<u>Cash flows from financing activities:</u>			
Proceeds from issuance of shares upon public offering, net	201,724	-	180,934
Proceeds from issuance of shares upon exercise of options and ESPP, net	25,259	38,987	20,273
Receipt of short-term bank loan	-	-	120,000
Repayment of short-term bank loan	-	-	(120,000)
Excess tax benefit from share-based payments arrangements	-	5,733	4,945
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	<u>226,983</u>	<u>43,662</u>	<u>206,152</u>
Effect of exchange rate changes on cash	<u>(12)</u>	<u>(390)</u>	<u>844</u>
Increase (decrease) in cash and cash equivalents	228,377	(187,591)	49,254
Cash and cash equivalents at the beginning of the year	<u>26,579</u>	<u>254,956</u>	<u>67,365</u>
Cash and cash equivalents at the end of the year	<u>\$ 254,956</u>	<u>\$ 67,365</u>	<u>\$ 116,619</u>
<u>Supplemental disclosure of cash flows activities:</u>			
<u>Cash paid during the year for:</u>			
Income taxes	<u>\$ 389</u>	<u>\$ 1,407</u>	<u>\$ 2,199</u>
Interest	<u>\$ -</u>	<u>\$ 40</u>	<u>\$ 668</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,		
	2005	2006	2007
(a) <u>Payment (refund) 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	(2,000)	
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>			
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	500
Other long-term liabilities	(38)	-	-
	2,011	500	500
Less - accrued acquisition costs	(122)	-	-
	<u>\$ 1,889</u>	<u>\$ 500</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 deferred acquisition costs		(256)	-
Less - accrued earn out payment		(6,233)	4,975
		<u>\$ 21,320</u>	<u>\$ 4,975</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
(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		(149)
Property and equipment	315		-
In-process research and development	12,670		-
Other intangible assets	78,170		-
Goodwill	140,900		149
Long-term deferred tax liabilities	(28,909)		-
		204,833	-
Payment (provision) on account of purchase price		(1,671)	1,500
	<u>\$ 203,162</u>		<u>\$ 1,500</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
(f) <u>Payment for the acquisition of Actimize:</u>			
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Working capital deficit (excluding cash and cash equivalents)			\$ (8,919)
Property and equipment			622
Severance pay fund			324
Long-term other receivables and prepaid expenses			332
In-process research and development			3,710
Other intangible assets			71,300
Goodwill			219,543
Long-term deferred tax liabilities			(13,028)
Other long-term liabilities			(854)
			<u>273,030</u>
Less - accrued acquisition costs			(1,853)
Less - amount acquired by issuance of shares and options, net of issuance expenses			<u>(60,637)</u>
			<u>\$ 210,540</u>
(g) <u>Non-cash activities:</u>			
Tax benefit on offering expenses	<u>\$ 1,002</u>	<u>\$ (585)</u>	<u>\$ 10</u>
Accrued offering expenses	<u>\$ 346</u>	<u>\$ -</u>	<u>\$ 105</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, operational risk management software solutions 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.

Actimize Ltd., the Company's subsidiary, offers operational risk management software solutions to the sector of financial services institutions, enabling them to manage the challenges of regulatory compliance, internal policy enforcement, fraud prevention and anti-money laundering.

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 14c.

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

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.

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 consummation date").

The following table summarizes the 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>\$ 38,000</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

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%.

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 years 2005 through 2006. In the second quarter of 2006 and in the second quarter of 2007, the Company paid additional consideration in the amounts of \$ 500 and \$ 500, respectively due to meeting the performance criteria relating to years 2005 and 2006. Accordingly, the Company recorded additional goodwill in the total amount of \$ 1,000.

Hannamax was NICE's distributor in the Australia and New Zealand markets. With the acquisition of Hannamax, the Company expanded its customer base and presence in Australia and New Zealand and expanded and strengthened 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 consummation 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 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>2,159</u>
 Total assets acquired	 <u>3,765</u>
 Trade payables	 (91)
Accrued expenses and other liabilities	(625)
Other long-term liabilities	<u>(38)</u>
 Total liabilities assumed	 <u>(754)</u>
 Net assets acquired	 <u>\$ 3,011</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 based on certain financial performance criteria covering years 2006 and 2008 (of which \$ 7,000 in respect of 2006 and \$ 5,000 in respect of 2008).

During the fourth quarter of 2006 the Company estimated that an additional consideration for earn out in the amount of approximately \$ 6,233 would be paid by the Company on account of 2006 earn out; accordingly, the Company recorded additional goodwill in this amount. See also Note 10(c)(6).

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

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.

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 consummation 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	<u>17,042</u>
 Total assets acquired	 <u>32,441</u>
 Short-term bank credit	 (785)
Trade payables	(1,568)
Accrued expenses and other liabilities	(792)
Long-term deferred tax liabilities	<u>(1,449)</u>
 Total liabilities assumed	 <u>(4,594)</u>
 Net assets acquired	 <u>\$ 27,847</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

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%.

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). According to the agreement 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. Since the performance criteria have not been met, no additional payment was made in 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 consummation 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	\$ 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	<u>8,292</u>
 Total assets acquired	 <u>17,783</u>
 Trade payables	 (1,328)
Accrued expenses and other liabilities	(2,521)
Long-term deferred tax liability	<u>(24)</u>
 Total liabilities assumed	 <u>(3,873)</u>
 Net assets acquired	 <u>\$ 13,910</u>

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.

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 IEX. The results of the IEX operations have been included in the consolidated financial statements since July 7, 2006 ("the consummation date").

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

Cash	\$ 67
Trade receivables	7,215
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>141,049</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%.

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

6. Acquisition of Actimize Ltd. ("Actimize"):

On August 30, 2007 the Company consummated an agreement to acquire all of the outstanding shares of Actimize Ltd. ("Actimize"), a leading provider of transactional risk management software for the financial services industry, for an aggregate consideration of \$ 281,111. The total purchase price of Actimize was composed of the following:

Cash	\$ 217,224
Shares *)	53,217
Options and Restricted Shares Awards **)	7,670
Acquisition related transaction costs ***)	<u>3,000</u>
 Total purchase price	 <u><u>\$ 281,111</u></u>

*) Represents the fair value of 1,501,933 American Depositary Shares ("ADSs") of NICE issued to Actimize shareholders upon consummation of the acquisition, valued based on the market price of the securities a few days before and after the terms of the acquisition were agreed to and announced, in accordance with EITF 99-12.

***) Represents the fair value of the vested portion of 987,104 options and restricted shares of Nice granted upon consummation of the acquisition to the holders of partially vested options and restricted shares of Actimize originally granted under Actimize's 2003 Omnibus Stock Option and Restricted Stock Incentive Plan. The fair value of these options was determined using a Black-Scholes-Merton valuation model with the following assumptions: expected life of 0-4 years, risk-free interest rate of 4.85%-4.99%, expected volatility of 30.7%-35.8% and no dividend yield. The fair value of the vested portion of the options is included herein as part of the total purchase price.

****) Acquisition related transaction costs include investment banking fees, legal and accounting fees and other external costs directly related to the acquisition.

On August 29, 2007, to finance a portion of the cash consideration for the Actimize acquisition, the Company entered into an unsecured loan agreement and a letter of undertaking with a bank, which provide for a term loan of \$ 120,000, originally repayable in one installment on February 29, 2008. The loan bore interest payable monthly, at an annual rate of LIBOR plus a margin of 0.45%. On September 28, 2007, the Company repaid the loan.

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

The acquisition of Actimize allows NICE to offer its customers and partners a more extensive product portfolio in the industries in which NICE operates. Actimize is a leading provider of software solutions for anti-money laundering, brokerage compliance, customer due diligence and fraud prevention. Built on a patented, scalable and extensible analytics platform, Actimize solutions enable financial institutions to increase their insight into real-time customer behavior and improve risk and compliance performance. By purchasing Actimize, the Company strategically strengthened its position as an enterprise wide analytics powerhouse and expanded its solution offering. The factors that contributed to the purchase price that resulted in recognition of goodwill, included the leverage for vertical markets 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 Actimize. The results of the Actimize operations have been included in the consolidated financial statements since August 30, 2007 ("the consummation date").

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

Cash	\$ 8,081
Marketable securities	6,140
Trade receivables	4,503
Short-term other receivables and prepaid expenses	1,648
Short-term deferred tax assets	925
Property and equipment	622
Severance pay fund	324
Long-term other receivables and prepaid expenses	332
Trade name	1,680
Core technology	38,480
In-process research and development	3,710
Customer relationships	31,140
Goodwill	219,543
	<hr/>
Total assets acquired	317,128
	<hr/>
Trade payables	(1,729)
Accrued expenses and other liabilities	(18,403)
Short-term deferred tax liabilities	(2,003)
Long-term deferred tax liabilities	(13,028)
Other long-term liabilities	(854)
	<hr/>
Total liabilities assumed	(36,017)
	<hr/>
Net assets acquired	\$ 281,111
	<hr/> <hr/>

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

The \$ 3,710 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 \$ 71,300 are amortized using the straight-line method at an annual weighted average rate of 19%. Amortization expense for the above-mentioned intangible assets for the five years ending December 31, 2012 is estimated to be \$ 63,433.

7. 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, 2006 and 2007, assuming that the acquisitions of CRS and Hannamax occurred on January 1, 2005, the acquisitions of FAST, Performix and IEX occurred on January 1, 2005 and 2006 and the acquisition of Actimize occurred on January 1, 2006 and 2007. The pro forma information is not necessarily indicative of the results of operations, which actually would have occurred had the acquisitions been consummated on those dates, nor does it purport to represent the results of operations for future periods.

In-process research and development write offs in respect of the acquisitions of FAST, IEX and Actimize were not included in the pro forma condensed results of operation since they are non-recurring charges.

	Year ended December 31,		
	2005	2006	2007
	Unaudited		
Revenues	<u>\$ 401,651</u>	<u>\$ 468,259</u>	<u>\$ 537,467</u>
Net income	<u>\$ 21,011</u>	<u>\$ 6,045</u>	<u>\$ 15,436</u>
Basic net earnings per share	<u>\$ 0.55</u>	<u>\$ 0.12</u>	<u>\$ 0.28</u>
Diluted net earnings per share	<u>\$ 0.51</u>	<u>\$ 0.11</u>	<u>\$ 0.27</u>

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 income 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 income 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 original 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.

Marketable securities classified as "available-for-sale" are carried at fair value, based on quoted market prices. Unrealized gains and losses are reported in a separate component of shareholders' equity in accumulated other comprehensive income. Gains and losses are recognized when realized, on a specific identification basis, in the Company's consolidated statements of income.

Impairment losses are recognized as realized or when the Company has determined that an other-than-temporary decline in fair value has occurred. FASB Staff Position ("FSP") No. 115-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investment" ("FSP 115-1") and SAB Topic 5M, "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities" provide guidance for determining when an investment is considered impaired, whether impairment is other-than temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment decreased below its cost in an other than temporary manner. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other than temporary, then an impairment loss should be recognized equal to the difference between the investment's cost and its fair value. FSP 115-1 nullifies certain provisions of Emerging Issues Task Force ("EITF") Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1") while retaining the disclosure requirements of EITF 03-1.

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

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 2005, 2006 and 2007 were \$ 4,646, \$ 5,095 and \$ 2,716, 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.

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

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

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

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:

	Weighted average %
Capitalized software development costs (see n)	33
Core technology	17
Trademarks	20
Customer relationships and distribution network	12
Maintenance contracts	33

k. Impairment of long-lived assets:

The Company's long-lived assets and identifiable intangibles that are subject to amortization 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 2005, 2006 and 2007, no impairment indicators have been identified.

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. 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 2005, 2006 and 2007 and did not identify any impairment losses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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") No. 97-2, "Software Revenue Recognition" (as amended by SOP No. 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 collectability is probable.

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

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.

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 project management services is established based on a price per day which is identical to price per day charged for installation services.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from fixed price contracts that require significant customization, integration and installation are recognized based on SOP No. 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" using the percentage-of-completion method of accounting based on the ratio of hours incurred to date to the total estimated hours of the contract. The amount of revenue recognized is based on the total license fees under the license agreement and the percentage of completion achieved. The revenues from such arrangements are allocated between products and services revenues to reflect the portion of each revenue source separately. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of similar contracts and are reviewed and updated regularly by management. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. As of December 31, 2007, no such estimated losses were identified.

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. As of December 31, 2005, 2006 and 2007 provision for product returns amounted \$ 1,155, \$ 1,975, and \$ 2,823, respectively.

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 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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.

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

The Company has decided to classify interest as financial expenses and penalties as general and administrative expenses. The Company's policy for interest and penalties related to income tax exposures was not impacted as a result of the adoption of the recognition and measurement provisions of FIN No. 48.

As a result of the implementation of FIN No. 48, the Company recognized a \$ 824 decrease in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings.

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.

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 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 and structured notes. The Company's investment policy limits the amount the Company may invest in any one type of investment or issuer, thereby reducing credit risk concentrations.

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. The derivative instruments effectively hedge the Company's non-dollar currency exposure (see 2(x) below).

r. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to Israel's 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.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes immaterial profits.

Severance pay expense for 2005, 2006 and 2007 amounted to \$ 3,622, \$ 4,305 and \$ 5,680, 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 2005, 2006, and 2007 the Company recorded an expense for matching contributions in the amount of \$ 812, \$ 1,176 and \$ 1,769 respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- 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 and restricted shares excluded from the calculations of diluted net earnings per share was 1,937,222, 705,589 and 1,817,895 for the years 2005, 2006 and 2007, 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.

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 year ended December 31, 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 years ended December 31, 2006 and 2007, 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.

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

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.

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 years ended December 31, 2006 and 2007 was estimated using the following assumptions:

	<u>2006</u>	<u>2007</u>
Expected volatility	33.9%-40.6%	32.5%-37.9%
Weighted average volatility	40.0%	37.5%
Risk free interest rate	4.6%-4.9%	3.3%-4.6%
Expected dividend	0%	0%
Expected term (in years)	2.3-3.7	2.5-3.7

A summary of the Company's stock options activity and related information for the year ended December 31, 2007, is as follows:

	<u>Number of options</u>	<u>Weighted- average exercise price</u>	<u>Weighted- average remaining contractual term (in years)</u>	<u>Aggregate intrinsic value</u>
Outstanding at January 1, 2007	5,657,656	\$ 16.69	4.1	\$ 79,749
Granted *)	2,883,725	\$ 30.28		
Exercised **)	1,618,286	\$ 12.23		
Forfeited	<u>462,500</u>	<u>\$ 19.92</u>		
Outstanding at December 31, 2007	<u>6,460,595</u>	<u>\$ 23.64</u>	<u>4.3</u>	<u>\$ 70,697</u>
Exercisable at December 31, 2007	<u>1,759,757</u>	<u>\$ 16.60</u>	<u>3.4</u>	<u>\$ 31,189</u>

*) Includes 564,225 options issued upon the acquisition of Actimize.

***) The weighted-average grant-date fair value of options granted during the years 2005, 2006 and 2007 was \$ 6.73, \$ 9.20 and \$ 11.8, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The total intrinsic value of options exercised during the years 2006 and 2007 was \$ 41, 249 and \$ 40,735, respectively.

A summary of the Company's Restricted Stock Awards ("RSA") activity and related information for the year ended December 31, 2007, is as follows:

	<u>Number of RSA</u>	<u>Weighted-average exercise price</u>
Outstanding at January 1, 2007	-	
Issued upon Actimize acquisition	422,879	\$ 35.03
Vested	<u>10,038</u>	<u>\$ 35.03</u>
Outstanding at December 31, 2007	<u>412,841</u>	<u>\$ 35.03</u>

As of December 31, 2007, there was approximately \$ 25,789 and \$ 10,152 of unrecognized compensation expense related to non-vested stock options and restricted stock awards, respectively, expected to be recognized over four years.

The options outstanding under the Company's Stock Option Plans as of December 31, 2007 have been separated into ranges of exercise price as follows:

<u>Ranges of exercise price</u>	<u>Options outstanding as of December 31, 2007</u>	<u>Weighted average remaining contractual term (Years)</u>	<u>Weighted average exercise price</u>	<u>Options exercisable as of December 31, 2007</u>	<u>Weighted Average Exercise price of Options Exercisable</u>
\$ 0.02	4,692	5.75	\$ 0.02	-	\$ -
2.46-2.89	110,994	2.96	2.79	45,306	2.64
3.91-5.57	63,902	1.02	5.04	63,902	5.04
6.00-8.28	212,708	4.26	6.65	58,425	6.86
9.66-14.04	729,425	2.86	10.62	402,466	10.36
14.60-20.63	1,912,600	3.80	17.50	783,781	17.32
22.33-32.31	1,192,562	4.49	26.09	404,032	26.12
34.78-38.44	<u>2,233,712</u>	<u>5.38</u>	<u>35.07</u>	<u>1,845</u>	<u>35.06</u>
	<u>6,460,595</u>	<u>4.3</u>	<u>\$ 23.64</u>	<u>1,759,757</u>	<u>\$ 16.6</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 earnings per share for the year ended December 31, 2005, if the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company's stock option plans 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:

Expected volatility	43.1%
Dividend yield	0%
Risk free interest rate	4.1%
Expected term (in years)	3.83

	Year ended December 31, 2005
Net income as reported	\$ 36,569
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(9,382)</u>
Pro forma net income	<u>\$ 27,187</u>
Basic net earnings per share as reported	<u>\$ 0.95</u>
Diluted net earnings per share as reported	<u>\$ 0.89</u>
Pro forma basic net earnings per share	<u>\$ 0.71</u>
Pro forma diluted net earnings per share	<u>\$ 0.66</u>

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).

The fair value of derivative instruments is estimated by obtaining quotes from brokers.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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 2005, 2006 and 2007 were \$ 3,798, \$ 5,918 and \$ 6,479, 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 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.

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.

At December 31, 2007, the Company expects to reclassify \$ 482 of net gains on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

y. Reclassification:

Certain amounts from prior years have been reclassified to conform to the current year's presentation. The reclassification had no effect on previously reported net income, shareholders' equity or cash flows.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

z. New accounting pronouncement:

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for the Company beginning January 1, 2008. The FASB issues a FASB Staff Position (FSP) to defer the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company does not expect the adoption will have material impact 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"). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. The provisions of SFAS No. 159 are effective for the Company beginning January 1, 2008. The Company does not expect the adoption of SFAS No. 159 will have an impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. The Company believes that the adoption of SFAS 141R could have an impact on its consolidated financial statements; however, the impact would depend on the nature, terms and magnitude of acquisitions it consummates in the future.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the non-controlling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently.

SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the adoption of SFAS No. 160 will have significant impact on its consolidated financial statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- MARKETABLE SECURITIES

a. Held-to-maturity

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, 2006 and 2007:

	Amortized cost		Gross unrealized gains		Gross unrealized losses		Estimated fair value	
	December 31,		December 31,		December 31,		December 31,	
	2006	2007	2006	2007	2006	2007	2006	2007
Corporate debentures	\$102,597	\$ 181,192	\$ 45	\$ 973	\$ (970)	\$ (631)	\$	\$ 181,534
U.S Government debentures	93,820	54,278	-	42	(775)	(94)	93,045	54,226
Structured notes	9,680	5,680	-	-	(123)	(70)	9,557	5,610
	<u>\$ 206,097</u>	<u>\$ 241,150</u>	<u>\$ 45</u>	<u>\$ 1,015</u>	<u>\$ (1,868)</u>	<u>\$ (795)</u>	<u>\$ 204,274</u>	<u>\$ 241,370</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, 2007:

	December 31, 2007					
	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Corporate debentures	\$ 35,383	\$ (447)	\$ 356,89	\$ (184)	\$ 71,072	\$ (631)
U.S Government debentures	6,014	(10)	15,816	(84)	21,830	(94)
Structured notes	1,930	(70)	-	-	1,930	(70)
	<u>\$ 433,27</u>	<u>\$ (527)</u>	<u>\$ 51,505</u>	<u>\$ (268)</u>	<u>\$ 94,832</u>	<u>\$ (795)</u>

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 small 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, 2007.

In 2007 the Company sold debt securities, which were classified as held-to-maturity, due to a rating decrease, in consideration of \$ 5,736. As a result of the sale, the Company recorded a loss of \$ 203. 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 these years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- MARKETABLE SECURITIES (Cont.)

During 2006 and 2007, held-to-maturity marketable securities in the amount of \$ 3,000 and \$ 24,364 respectively, were called by the issuers prior to maturity.

The scheduled maturities of held-to-maturity marketable securities at December 31, 2007 were as follows:

	<u>Amortized cost</u>	<u>Estimated fair value</u>
Held-to-maturity:		
Due within one year	\$ 82,890	\$ 82,812
Due after one year through five years	155,260	155,558
Due after five years through ten years	<u>3,000</u>	<u>3,000</u>
	<u>\$ 241,150</u>	<u>\$ 241,370</u>

b. Available-for-sale

The following table summarizes amortized costs, gross unrealized gains and losses and estimated fair values of available for sale investments as of December 31, 2006 and 2007:

	<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>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>
						\$		
U.S Government debentures	\$ -	\$ 1,199	\$ -	\$ -	\$ -	-	\$ -	\$ 1,199
Auction Rate Securities	<u>22,572</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>22,572</u>	<u>-</u>
	<u>\$22,572</u>	<u>\$ 1,199</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,572</u>	<u>\$ 1,199</u>

The scheduled maturity of available-for-sale securities at December 31, 2007 is within one year.

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

	<u>December 31,</u>	
	<u>2006</u>	<u>2007</u>
Government authorities	\$ 2,355	\$ 4,090
Interest receivable	2,113	3,765
Prepaid expenses	4,771	9,273
Assets of discontinued operation	646	170
Other	<u>1,514</u>	<u>3,451</u>
	<u>\$ 11,399</u>	<u>\$ 20,749</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- INVENTORIES

	December 31,	
	2006	2007
Raw materials	\$ 2,457	\$ 1,717
Work-in-progress	56	115
Finished goods	16,106	10,003
	<u>\$ 18,619</u>	<u>\$ 11,835</u>

NOTE 6:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2006	2007
Cost:		
Computers and peripheral equipment	\$ 61,941	\$ 69,838
Office furniture and equipment	15,157	16,180
Leasehold improvements	4,443	5,301
	<u>81,541</u>	<u>91,319</u>
Accumulated depreciation:		
Computers and peripheral equipment	52,382	57,262
Office furniture and equipment	10,079	11,580
Leasehold improvements	3,267	3,822
	<u>65,728</u>	<u>72,664</u>
Depreciated cost	<u>\$ 15,813</u>	<u>\$ 18,655</u>

Depreciation expense totaled \$ 7,941, \$ 8,244 and \$ 8,740 for the years 2005, 2006 and 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- OTHER INTANGIBLE ASSETS, NET

- a. Other intangible assets:

	December 31,	
	2006	2007
Original amounts:		
Capitalized software development costs	\$ 5,037	\$ 8,207
Core technology	60,910	99,675
Trademarks	6,642	8,366
Customer relationships and distribution network	60,533	92,262
Maintenance contracts	582	-
	<u>133,704</u>	<u>208,510</u>
Accumulated amortization:		
Capitalized software development costs	2,500	5,877
Core technology	11,869	23,148
Trademarks	1,854	3,200
Customer relationships and distribution network	5,717	13,970
Maintenance contracts	582	-
	<u>22,522</u>	<u>46,195</u>
Other intangible assets, net	<u>\$ 111,182</u>	<u>\$ 162,315</u>

- b. Amortization expense amounted to \$ 5,211, \$ 13,675 and \$ 22,186 for the years 2005, 2006 and 2007, respectively.
- c. Estimated amortization expense for the years ended (excluding amortization of capitalized software development costs):

<u>December 31,</u>	
2008	\$ 29,246
2009	28,637
2010	28,173
2011	24,675
2012	21,074
2013 and thereafter	<u>28,180</u>
	<u>\$ 159,985</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 8:- GOODWILL**

The changes in the carrying amount of goodwill for the years ended December 31, 2006 and 2007 are as follows:

	December 31,	
	2006	2007
Goodwill, beginning of the year	\$ 49,853	\$ 220,430
Additions in respect of acquisitions	166,734	220,192
Adjustment to goodwill in respect of settlement with CRS	1,000	-
Foreign currency translation adjustments	2,843	2,634
Goodwill, end of year	<u>\$ 220,430</u>	<u>\$ 443,256</u>

NOTE 9:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2006	2007
Employees and payroll accruals	\$ 26,877	\$ 36,432
Accrued expenses	45,234	56,529
Deferred revenues and advances from customers	60,684	93,293
Other	14,195	21,831
	<u>\$ 146,990</u>	<u>\$ 208,085</u>

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

2008	\$ 10,653
2009	8,626
2010	3,628
2011	2,446
2012	1,574
2013 and thereafter	<u>174</u>
	<u>\$ 27,101</u>

Rent expenses for the years 2005, 2006 and 2007 were approximately \$ 6,317, \$ 8,668 and \$ 10,531, 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 \$ 932 as of December 31, 2007.

Lease expenses for motor vehicles for the years 2005, 2006 and 2007 were \$ 2,552, \$ 2,865 and \$ 4,041, 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, 2007, were \$ 3,801. These obligations will be fulfilled during 2008.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

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 took place on January 20, 2008. The Court determined that an accountant from one of the big five accounting firms will examine the damages claimed by CipherActive and will submit an opinion within 90 days. The Company is currently unable to evaluate the probability of a favorable or unfavorable outcome.

2. On July 20, 2004, STS Software System Ltd. ("STS"), a wholly owned subsidiary of the Company, brought a lawsuit against Witness Systems, Inc. (currently: Verint America Inc., a wholly owned subsidiary of Verint Systems, Inc.) ("Witness Systems") 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. By order of the Court on June 26, 2007, the Company joined as a plaintiff in the litigation. A trial took place in the U.S. District Court for the Northern District of Georgia during the week of March 17, 2008. Prior to the trial the Company removed two U.S patents from the litigation. A decision by the court is expected in May 2008.

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 damages in an amount ranging between \$ 17,000 and \$ 33,000 and an 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., the Company's vendor. The case is currently in discovery and no trial date has been set.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

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 and trial is expected to begin on May 12, 2008.

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 claimed 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 requested 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 sought damages for Witness Systems' past willful infringement of these patents. The case went to trial before a jury on January 14, 2008. The jury deadlocked and on January 25, 2008 a mistrial was declared. The Company has filed a motion for a new trial date for the case. A new trial date has not been set yet.

For the above-mentioned legal proceedings, the Company currently is not able to evaluate the probability for favorable or unfavorable outcome with any degree of certainty.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)**

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

3. In or about February 2005, the Company received correspondence from Origin Data Realisation Limited ("Origin"), notifying the Company of a potential claim against it in relation to an alleged breach of the terms of a license of software and other matters. Following lengthy negotiations, the dispute was recently settled and a new license agreement was entered into between the parties in December 2007.
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, but the documentation for this settlement has not been finalized and executed by the parties.
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 dispute was submitted to mediation, however the mediation process failed and the proceedings were returned to the District Court of Tel Aviv. This lawsuit is in its initial stages and the first hearing is scheduled to take place on September 18, 2008. The Company is currently unable to evaluate the probability of a favorable or unfavorable outcome.
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 (€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. On June 19, 2007, the Company and Formatest AG entered into an agreement settling all claims. The Company believes it is entitled to recover all or a substantial part of the settlement amount paid to Formatest AG (with the addition of legal costs), under the terms of indemnification provision contained in the sale and purchase agreement between the selling shareholders of FAST Video Security AG (the "Sellers") and the Company dated November 16, 2006 (the "Agreement"). The Company blocked escrow funds from being released to the Sellers under the Agreement in the amount of \$ 3,000 and also declared its right to set off of the settlement amount paid to Formatest AG against the Sellers' first earn out payment pursuant to the Agreement. On December 18, 2007, the Sellers issued a Notice of Arbitration in the Zurich Chamber of Commerce, claiming that the Company should pay them an amount of \$ 1,229 (plus late payment interest of 5% from July 2007), which is the remaining unpaid portion of the first earn out payment under the Agreement, release \$ 3,000 (plus accrued interest) from the escrow account pursuant to the Agreement, plus an additional late release interest of 5%, and compensate them for loss incurred due to deteriorating exchange rates and other related expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

In accordance with its assessment of the Sellers' liability and in order to reduce arbitration costs, the Company decided to release to the Sellers a partial payment of \$ 1,400 out of the escrow funds and to pay to the Sellers the amount of \$ 1,229 prior to the commencement of the arbitration proceedings. On February 20, 2008 the Company filed a counterclaim against the Sellers for indemnity under the Agreement as of the time of filing to approximately \$ 1,360. The arbitration proceedings are at an initial stage and parties are in the process of jointly designating an arbitrator.

7. On October 26, 2007, two former employees of Nice Systems Inc. filed a lawsuit against the Company and Nice Systems Inc, alleging violations of various laws prohibiting discrimination in employment. The plaintiffs are seeking lost earnings and benefits, compensatory damages for emotional injury and injury to reputation and punitive damages, as well as attorneys' fees and costs. The Company has filed its answer and the Court has held an initial conference and entered a scheduling order. The case is in its early stage of discovery. The Company is currently unable to evaluate the probability of a favorable or unfavorable outcome.
8. On December 19, 2007, a former employee of Nice Systems Inc. sent the Company and Nice Systems Inc. a letter alleging engagement in prohibited discrimination in employment and retaliation in terminating his employment. The former employee has made a settlement demand. The Company is currently in the process of assessing and responding to the letter. The Company is currently unable to evaluate the probability of a favorable or unfavorable outcome.
9. The Company is involved in various other legal proceedings arising in the normal course of its business. Based upon the advice of counsel, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

NOTE 11:- CREDIT LINES

As of December 31, 2007, the Company had authorized credit lines from banks in the amount of approximately \$ 312,000. 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 \$ 278,000 out of the total credit lines is secured by the Company's cash and cash equivalents and marketable securities. As of December 31, 2007, \$ 12,857 of the \$ 312,000 referred to above was used for bank guarantees (of which \$ 10,857 is for continuing operations and \$ 2,000 is for letters of credit). 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 12:- 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 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.

The Company's wholly owned subsidiary, Actimize Ltd., has received approval as an Approved Enterprise in Israel under the Law, for two investment programs and is therefore eligible for Israeli tax benefits. Pursuant to these benefits, Actimize Ltd. may enjoy a tax exemption from Israeli taxes on income derived during the first two years in which each investment program produces taxable income, subject to certain timing restrictions, provided that it does not distribute such income as a dividend. In addition, Actimize Ltd. will enjoy a reduced tax rate of 10% - 25%, (based on the percentage of foreign ownership in each taxable year) for an additional period of eight years. The benefit periods have not yet commenced.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- TAXES ON INCOME (Cont.)

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 the Company 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.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Law and regulations published thereunder. Should the Company 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, 2007, management believes that the Company 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's first program benefits under the Amendment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- TAXES ON INCOME (Cont.)

As a result of the Amendment, tax-exempt income generated under the Company's Privileged Enterprise program, 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 or Privileged Enterprise programs as the undistributed tax exempt income is essentially permanent in duration.

As of December 31, 2007, approximately \$ 116,000 is tax-exempt attributable to its various Approved and Privileged 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 10%-25%) and an income tax liability of up to approximately \$ 21,700 would be incurred as of December 31, 2007.

Income from sources other than an Approved or a Privileged 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, 2007, the Company had carryforward tax losses totaling approximately \$ 46,500 which can be carried forward and offset against taxable income with expiration dates ranging from 2008 and onwards. Approximately \$ 28,300 of these carryforward tax losses have no expiration date. The balance expires between 2008 and 2027.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 12:- TAXES ON INCOME (Cont.)**

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.

NOTE 12:- TAXES ON INCOME (Cont.)

Of the Company's total carry forward tax losses, approximately \$ 35,600 were inherited at the time of the acquisition of certain of the Company's subsidiaries. A valuation allowance of \$ 4,200 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.

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,	
	2006	2007
Deferred tax assets:		
Net operating losses carryforward	\$ 11,412	\$ 10,510
Acquired intangibles	6,881	6,244
Other	5,679	12,736
	<u>23,972</u>	<u>29,490</u>
Deferred tax assets before valuation allowance	23,972	29,490
Valuation allowance	(6,577)	(6,182)
	<u>17,395</u>	<u>23,308</u>
Deferred tax assets	17,395	23,308
Deferred tax liabilities:		
Acquired intangibles	(33,130)	(48,075)
	<u>(33,130)</u>	<u>(48,075)</u>
Deferred tax liabilities, net	<u>\$ (15,735)</u>	<u>\$ (24,767)</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 the valuation allowance in 2007 amounted to \$ 395 resulted from an increase of \$ 978 related to business combinations, and a decrease of \$ 1,373 related to operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 12:- 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,		
	2005	2006	2007
Income before taxes on income, as reported in the consolidated statements of income	\$ 37,471	\$ 30,992	\$ 47,634
Statutory tax rate in Israel	34%	31%	29%
Approved and Privileged Enterprise benefits *)	(1.9%)	(14.6%)	(10.1%)
Changes in valuation allowance	(30.8%)	3.8%	(1.4%)
Earnings taxed under foreign law	-	(7.4%)	(2.6%)
Acquired in-process research and development	-	14.6%	2.3%
Permanent items and other	1.1%	0.3%	4.3%
Effective tax rate	2.4%	27.7%	21.5%
*) Net earnings per Ordinary share - amounts of the benefit resulting from the "Approved and Privileged Enterprise" status			
Basic	\$ 0.02	\$ 0.09	\$ 0.09
Diluted	\$ 0.01	\$ 0.09	\$ 0.09

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

	Year ended December 31,		
	2005	2006	2007
Domestic	\$ 30,681	\$ 33,629	\$ 27,506
Foreign *)	6,790	(2,637)	20,128
	\$ 37,471	\$ 30,992	\$ 47,634

- *) 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 12:- TAXES ON INCOME (Cont.)**

- g. Taxes on income are comprised as follows:

	Year ended December 31,		
	2005	2006	2007
Current	\$ 5,743	\$ 6,404	\$ 10,516
Deferred	(4,841)	2,187	(262)
	<u>\$ 902</u>	<u>\$ 8,591</u>	<u>\$ 10,254</u>
Domestic	\$ 1,553	\$ 5,892	\$ 4,254
Foreign	(651)	2,699	6,000
	<u>\$ 902</u>	<u>\$ 8,591</u>	<u>\$ 10,254</u>

- h. Uncertain tax positions:

A reconciliation of the beginning and ending balances of the total amounts of unrecognized tax benefits is as follows:

Balance at January 1, 2007	\$ 10,702
Increases in tax positions for prior years	1,315
Decreases in tax positions for prior years	(734)
Increases in tax positions for current year	3,805
Settlements	<u>(169)</u>
Balance at December 31, 2007 *)	<u>\$ 14,919</u>

- *) Unrecognized tax benefits included \$ 14,307 of tax benefits, which if recognized, would reduce the Company's annual effective tax rate. The unrecognized tax benefits included an immaterial accrued interest as of December 31, 2007.

As of December 31, 2007, the Company is subject to Israeli income tax audits for the tax years 2002 through 2007, to U.S. federal income tax audits for the tax years of 2003 through 2007 and to other income tax audits for the tax years of 2002 through 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- 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 September and October 2007 the Company completed a secondary public offering of its ADS's on NASDAQ. The Company issued 5,175,000 shares (including 675,000 ADS issued upon the exercise of an option by the underwriters on October 10, 2007) at a price of \$ 35.02 per share before issuance expenses. Total net proceeds from the issuance amounted to approximately \$ 180,829.

On August 30, 2007 the Company acquired all of the outstanding shares of Actimize Ltd. ("Actimize"). As part of the acquisition, the Company issued 1,501,933 American Depositary Shares ("ADSs") of NICE, valued at \$ 53,217 – see Note 1(b)(6).

In December 2005, the Company effected a secondary public offering of its ADS 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.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)**

NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

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. Generally, Under the terms of the 2003 Plan, 25% of the stock options granted become exercisable on the first anniversary of the date of grant and 6.25% becomes exercisable once every quarter during the subsequent three years. Stock options expire six years after the date of grant. 9,058,500 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.

Pursuant to the terms of the acquisition of Actimize Ltd. in August 2007, the Company assumed and replaced the stock options and restricted shares granted by Actimize. In 2003, Actimize adopted the 2003 Omnibus Stock Option and Restricted Stock Incentive Plan, or the 2003 Actimize Plan. Under the 2003 Actimize Plan, the grantees could be granted options to acquire Actimize's Ordinary shares, restricted shares and shares. Incentive stock options to acquire Ordinary shares of Actimize were granted at an exercise price not less than the fair market value of the Ordinary shares of Actimize on the date of grant or as determined by Actimize's board of directors or by a committee thereof. In addition, the options were granted at an exercise price of not less than the par value of the Ordinary shares of Actimize.

In September 2007, the Company registered, through the filing of a registration statement on Form S-8 with the Securities and Exchange Commission ("SEC") under the Securities Act, an aggregate of 987,104 ADS, which are comprised of: (i) 564,225 ADS subject to issuance upon the exercise of stock options outstanding under the 2003 Actimize Plan; and (ii) 422,879 ADS representing restricted Ordinary shares issued in lieu of restricted shares issued under the 2003 Actimize Plan.

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. In 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 2005, 2006 and 2007, employees purchased 334,090, 8,570 and 16,041 shares at average prices of \$ 12.94, \$ 26.73 and \$ 31.08 per share, respectively.

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

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.

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.

NOTE 14:- REPORTABLE SEGMENTS, PRODUCT LINES AND MAJOR CUSTOMER DATA

a. Reportable segments:

In 2006, following the expansion of the operations in certain regions, the Company determined that it operates under several reportable segments and provided summarized financial information as set forth below. The following tables present the financial information of the Company's reportable segments.

	Year ended December 31, 2007					Total
	Americas	EMEA*)	APAC**)	Actimize	Not allocated	
Revenues	\$ 283,009	\$ 149,913	\$ 72,894	\$ 11,558	\$ -	\$ 517,374
Gross profit (loss)	\$ 176,678	\$ 98,184	\$ 51,818	\$ 4,110	\$ (19,758)	\$ 311,032
Operating expenses	\$ 63,779	\$ 34,272	\$ 13,426	\$ 20,127	\$ 146,594	\$ 278,198
Operating income (loss)	\$ 112,899	\$ 63,912	\$ 38,392	\$ (16,017)	\$ (166,352)	\$ 32,834

	Year ended December 31, 2006					Total
	Americas	EMEA*)	APAC**)	Not allocated		
Revenues	\$ 241,308	\$ 112,541	\$ 55,795	\$ -		\$ 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

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

***) Includes Asia Pacific

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 14:- REPORTABLE SEGMENTS, PRODUCT LINES AND MAJOR CUSTOMER DATA (Cont.)

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

	Year ended December 31,	
	2006	2007
Americas	\$ 261,408	\$ 254,826
EMEA	82,966	77,916
APAC	3,051	4,101
Actimize	-	287,383
	<u>\$ 347,425</u>	<u>\$ 624,226</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,		
	2005	2006	2007
Enterprise interaction solutions	\$ 237,353	\$ 300,920	\$ 382,893
Public safety and security sector	73,757	108,724	122,923
Operational risk management solutions	-	-	11,558
	<u>\$ 311,110</u>	<u>\$ 409,644</u>	<u>\$ 517,374</u>

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

Customer A	<u>21%</u>	<u>16%</u>	<u>13%</u>
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NOTE 15:- SELECTED STATEMENTS OF INCOME DATA

a. Research and development, net:

	Year ended December 31,		
	2005	2006	2007
Total costs	\$ 33,404	\$ 47,963	\$ 63,271
Less - grants and participations	(1,702)	(1,858)	(2,677)
Less - capitalization of software development costs	(806)	(1,225)	(962)
	<u>\$ 30,896</u>	<u>\$ 44,880</u>	<u>\$ 59,632</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands (except share and per share data)****NOTE 15:- SELECTED STATEMENTS OF INCOME DATA (Cont.)**

b. Financial income, net:

	Year ended December 31,		
	2005	2006	2007
Financial income:			
Interest and amortization/accretion of premium/discount on marketable securities	\$ 4,073	\$ 6,848	\$ 10,618
Interest	1,979	7,101	5,499
Foreign currency translation	258	1,434	1,581
	<u>6,310</u>	<u>15,383</u>	<u>17,698</u>
Financial expenses:			
Interest	-	(40)	(668)
Foreign currency translation	(542)	(1,455)	(1,548)
Other	(370)	(616)	(658)
	<u>(912)</u>	<u>(2,111)</u>	<u>(2,874)</u>
	<u>\$ 5,398</u>	<u>\$ 13,272</u>	<u>\$ 14,824</u>

c. Net earnings per share:

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

1. Numerator:

	Year ended December 31,		
	2005	2006	2007
Net income available to Ordinary shareholders	\$ 36,569	\$ 22,401	\$ 37,380

2. Denominator (in thousands):

Denominator for basic net earnings per share - Weighted average number of shares	38,242	49,572	53,921
Effect of dilutive securities:			
Add - Employee stock options and RSA	3,042	2,429	2,005
Add - ESPP	8	1	-
Denominator for diluted net earnings per share - adjusted weighted average shares	<u>41,292</u>	<u>52,002</u>	<u>55,926</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 16:- SUBSEQUENT EVENT

On April 8, 2008, the Company acquired certain assets, shares and business from Quality Plus Group Ltd., a UK-based value-added distributor of NICE's contact center solutions, and its affiliates ("QPC"), for approximately \$12,300 in cash. The business acquired includes the sale, distribution, service, support, maintenance and development of workforce management solutions and associated services as conducted by QPC in the UK, Sweden and Australia.
