

MIND CTI LTD  
Form 20-F  
April 24, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

**OR**

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

**For the fiscal year ended December 31, 2011**

**OR**

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

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

**OR**

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

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

Commission file number 000-31215

MIND C.T.I. LTD.

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

ISRAEL

(Jurisdiction of incorporation or organization)

Industrial Park, Building #7, Yoqneam, 20692, Israel

(Address of principal executive offices)

Aviram Cohen  
c/o MIND C.T.I. Ltd.  
Industrial Park, Building #7  
Yoqneam, 20692, Israel  
Tel: +972-4-9936666  
[investor@mindcti.com](mailto:investor@mindcti.com)

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

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2011, the Registrant had outstanding 18,729,918 Ordinary Shares, nominal value NIS 0.01 per share.

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

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

Item 17  Item 18

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

Yes  No

Unless the context requires otherwise, “MIND”, “us”, “we” and “our” refer to MIND C.T.I. Ltd. and its subsidiaries.

## **FORWARD LOOKING STATEMENTS**

Statements in this Annual Report concerning our business outlook or future economic performance; anticipated revenues, expenses or other financial items; introductions and advancements in development of products, and plans and objectives related thereto; and statements concerning assumptions made or expectations as to any future events, conditions, performance or other matters, are “forward-looking statements” as that term is defined under the United States Federal Securities Laws. Forward-looking statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from those stated in such statements. Factors that could cause or contribute to such differences include, but are not limited to, those set forth under “Risk Factors” in this Annual Report as well as those discussed elsewhere in this Annual Report and in our other filings with the Securities and Exchange Commission.

## **PART I**

### **Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

### **Item 2. Offer Statistics and Expected Timetable**

Not applicable.

### **Item 3. Key Information**

#### **A. Selected Financial Data**

Except as otherwise indicated, all financial statements and other financial information included in this Annual Report are presented solely under U.S. GAAP.

The following table presents selected consolidated financial data as of and for each of the five years in the period ended December 31, 2011. The selected consolidated financial data presented below are derived from our audited consolidated financial statements for these periods, and should be read in conjunction with these financial statements and the related notes thereto. Our audited consolidated financial statements as of December 31, 2010 and 2011 and for each of the three years in the period ended December 31, 2011 and the related notes thereto are hereby incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012. You should read the selected financial data in conjunction with Item 5 “Operating and Financial Review and Prospects.”

Years ended December 31,  
2007 2008 2009 2010 2011  
(In US \$ thousands, except share and per share data)

## Consolidated Statements of Operations Data:

Total revenues	\$18,447	\$19,473	\$17,574	\$19,886	\$18,913
Gross profit	12,663	13,347	11,161	13,719	12,437
Operating income (loss)	1,258	(2,294 )	2,169	4,995	3,935
Auction Rate Securities Settlement	-	-	18,500	-	-
Impairment of Auction Rate Securities	(15,187 )	(4,172 )	(941 )	-	-
Other Financial income (expenses) - net	2,082	568	256	49	171
Net income (loss)	(11,955 )	(6,423 )	19,787	4,856	4,291
Earnings (loss) per ordinary share:					
Basic	\$(0.55 )	\$(0.30 )	\$1.04	\$0.26	\$0.23
Diluted	\$(0.55 )	\$(0.30 )	\$1.04	\$0.26	\$0.23
Weighted average number of ordinary shares used in computation of earnings per ordinary share – in thousands:					
Basic	21,586	21,473	19,012	18,467	18,679
Diluted	21,586	21,473	19,012	18,613	18,803

As of December 31,  
2007 2008 2009 2010 2011  
(In US \$ thousands)

## Consolidated Balance Sheet Data:

Cash and cash equivalents	\$12,390	\$9,722	\$15,995	\$17,582	\$13,866
Working capital	13,441	9,668	15,315	18,119	16,999
Total assets	37,726	24,002	28,951	30,461	30,021
Share capital and additional paid-in capital	57,934	53,796	39,159	35,687	30,363
Treasury Shares	-	1,631	2,800	2,800	2,652
Total shareholders' equity	31,809	18,434	22,687	23,983	23,019

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

We believe that the occurrence of any one or some combination of the following factors would have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to Our Business

If we experience loss of one or more existing customers, we may suffer a decrease in revenues, reputation and profitability.

A significant part of our revenues is derived from maintenance agreements and managed services agreements. We have through the years sold niche solutions to large customers that may decide to unify the various solutions they have into one platform and dismantle niche solutions in the process, ours included, as occurred with respect to a few of our customers in 2011. Small services providers may be acquired by larger carriers and replace our solutions with the buyer's existing billing platform, as occurred with one of our customers in 2010. If one or more customers cease using our solutions or services due to replacements or any other reason, our profitability would be seriously harmed and our business and results of operations would suffer.

Because some of our customers require highly complex implementations and we sell fixed price projects, we may underestimate the effort and time required to implement such projects, resulting in a lower or negative profit margin for such projects and the incurrence of contractual penalties for late performance. This could materially harm our results of operations.

In 2011, we derived 78% of our revenues from the sale of software and related services to telecommunications service providers. As the deal size increases, our projects become more complex and the risk of on-time and on-budget implementation increases. Each such contract includes penalties and potential liability for damages arising from our late performance. These customers conduct a lengthy and complex approval and purchasing process, and the pricing for each project needs to be competitive in order to win. Our cost of sales increases as the length of the approval process increases because we need to support each opportunity during the time required for the customer to determine their specifications and the time required for the customer to receive internal approval to commit significant resources towards acquisition of the billing solution. The project implementation may be delayed due to delays in the build-up of the customer's network infrastructure. Our estimate for the cost includes the effort required to release new versions comprising enhanced functionality specifically requested by the customer.

All the delays, either by us or by a third party, increase the cost of supplying the project and expose us to potential claims from customers and may decrease our revenues and could materially harm our profitability, business and results of operations.

Adverse economic conditions have adversely affected, and may further adversely affect, our business and financial results.

The turmoil in the global financial and credit markets in recent years has caused liquidity problems for many financial institutions and adversely affected general economic conditions, as well as the telecommunications market in particular. Many new and small service providers have failed and existing service providers have been reducing or delaying expenditures on new equipment and applications, which has reduced our sales and adversely affected our results of operations. A continuation of adverse economic conditions may further reduce our sales and could result in additional pressure on the price of our products, both of which would have a material adverse effect on our operating results. A continuation of such conditions could also have a number of follow-on effects on our business, including (i) a negative impact on our liquidity, financial condition and share price, which may impact our ability to raise capital in the market, obtain financing and other sources of funding in the future on terms favorable to us, and (ii) a decrease in asset values that are deemed to be other than temporary, which may result in impairment losses.

If we are unable to compete effectively in the marketplace, we may suffer a decrease in market share, revenues and profitability.

Competition in our industry is intense and we expect competition to increase. We compete both with established global billing companies such as Amdocs (after the acquisition of Sigvalue Technologies by Amdocs), Comverse (after the acquisition of the Global Software Services division of CSG Systems International by Comverse) and Oracle Corporation (after the acquisition of Portal Software by Oracle) as well as with local billing companies. Some of our competitors have greater financial, technical, sales, marketing and other resources and greater name recognition than we do. Some of our competitors, mainly the ones that focus on specific markets, have a lower cost structure and compete with us on pricing. New competitors may emerge and rapidly acquire significant market share. We cannot guarantee that we will be able to compete effectively against current or future competitors or that competitive pressure will not harm our financial results.

Our business may be negatively affected by exchange rate fluctuations.

Although the majority of our revenues are denominated in U.S. dollars, approximately 34% of our expenses are incurred in New Israeli Shekel, or NIS, and approximately 41% of our expenses are incurred in Euro. As a result, we may be negatively affected by fluctuations in the exchange rates between the Euro or the NIS and the U.S. dollar. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation or appreciation of the NIS or of the Euro against the U.S. dollar. If the U.S. dollar cost of our operations in Israel and/or Romania increases, our U.S. dollar-measured results of operations will be adversely affected. In addition, some of our revenues are denominated in Euro and some are denominated in Great Britain Pound, or GBP. As a result, our U.S. dollar-measured results of operations will be adversely affected by devaluation in the GBP or Euro relative to the U.S. dollar. We may choose to limit these exposures by entering into hedging transactions. However, hedging transactions

may not enable us to avoid exchange-related losses, and our business may be harmed by exchange rate fluctuations.

If we fail to attract and retain qualified personnel we will not be able to implement our business strategy or operate our business effectively.

Our products require sophisticated research and development, sales and marketing, software programming and technical customer support. Our success depends on our ability to attract, train, motivate and retain highly skilled personnel within each of these areas of expertise. Qualified personnel in these areas are in great demand and are likely to remain a limited resource for the foreseeable future. We cannot assure you that we will be able to retain the skilled employees we require. In addition, the resources required to retain such personnel may adversely affect our operating margins. The failure to retain qualified personnel may harm our business. In particular, we maintain a large technical and support center in Jassy, Romania and have encountered many attempts from other technology companies to recruit our employees after we have trained them. If this phenomenon continues and increases, we may be forced to raise the salaries of our Romanian employees and our results of operations will be consequently harmed.

Because a substantial majority of our revenues are generated outside of Israel, our results of operations could suffer if we are unable to manage international operations effectively.

In 2010 and 2011, approximately 95% and 92% of our revenues, respectively, were generated outside of Israel. Our sales outside of Israel are made in more than 40 countries. We currently have sales and support offices located in Silver Spring, Maryland in the U.S. and in Reading, U.K. In addition, we have a technical and support team in Jassy, Romania. We may establish additional facilities in other parts of the world, either through acquisitions or internal expansion based on market needs. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. Our ability to penetrate some international markets may be limited due to different technical standards, protocols and requirements for our products in different markets. We cannot be certain that our investments in establishing facilities in other countries will produce desired levels of revenue. In addition, conducting our business internationally subjects us to a number of risks, including:

- staffing and managing foreign operations;
- increased risk of collection;
- potentially adverse tax consequences;
- the burden of compliance with a wide variety of foreign laws and regulations;
- burdens that may be imposed by tariffs and other trade barriers; and
- political and economic instability.

Our backlog, revenues and operating results may vary significantly from quarter to quarter.

Our backlog, revenues and operating results may vary significantly from quarter to quarter due to a number of factors, including the following:

· the timing of orders and/or deliveries for our software may be delayed as customers typically order and/or implement our billing and customer care software only after other vendors have provided the network infrastructure, a process that is subject to delay. It is therefore difficult for us to predict the timing of orders and/or revenue recognition;

the ability of our customers to expand their operations and increase their subscriber base, including their ability to obtain financing;

potential termination of long-term contracts by our customer due to lack of financing, internal changes or any other reason; and

changes in our pricing policies or competitive pricing by our competitors .

Due to all of the foregoing, we cannot predict revenues for any future quarter with any significant degree of accuracy. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and you should not rely upon them as indications of future performance. In future quarters, our operating results may be below the expectations of public market analysts and investors, and as a result, the price of our ordinary shares may fall.

The customer base for our wireline and wireless billing and customer care products is characterized by small to medium size telephony carriers. If this market segment fails to grow, the demand for our billing and customer care software would diminish substantially.

Our traditional wireline and wireless billing and customer care products target small to medium size telephony carriers. Our growth in this field depends on continued growth of these traditional telephony carriers. We cannot be certain that small to medium size telephony carriers will be able to successfully compete with large telephony carriers in existing markets or will successfully develop in new and emerging markets. If this market segment fails to grow, the demand for our billing and customer care software would diminish substantially and our business would suffer. In addition, there may never be significant demand for new billing and customer care software by providers of telecom services.

From time to time, our software and the systems into which it is integrated contain undetected errors. This may cause us to experience a significant decrease in market acceptance and use of our software products and we may be subject to warranty and other liability claims.

From time to time, our software, as well as the systems into which it is integrated, contains undetected errors. Because of this integration, it can be difficult to determine the source of the errors. Also, from time to time, hardware systems we resell contain certain defects or errors. As a result, and regardless of the source of the errors, we could experience one or more of the following adverse results:

diversion of our resources and the attention of our personnel from our research and development efforts to address these errors;

negative publicity and injury to our reputation that may result in loss of existing or future customers; and

loss of or delay in revenue and loss of market share.

In addition, we may be subject to claims based on errors in our software or mistakes in performing our services. Our licenses and agreements generally contain provisions such as disclaimers of warranties and limitations on liability for special, consequential and incidental damages, designed to limit our exposure to potential claims. However, not all of our contracts contain these provisions and we cannot assure you that the provisions that exist will be enforceable. In addition, while we maintain product liability and professional indemnity insurance, we cannot assure you that this insurance will provide sufficient, or any, coverage for these claims. A product liability or professional indemnity claim, whether or not successful, could adversely affect our business by damaging our reputation, increasing our costs, and diverting the attention of our management team.

We may expand our business through acquisitions that could result in diversion of resources and extra expenses, and which may involve other risks that could disrupt our business and harm our financial condition.

We may pursue acquisitions of business, products and technologies, or the establishment of joint venture arrangements, that could expand our business. The negotiation of potential acquisitions or joint ventures as well as the integration of an acquired or jointly developed business, technology or product could cause diversion of management's attention from the day-to-day operation of our business. This could impair our relationships with our employees, customers, distributors, resellers and marketing allies. Future acquisitions could result in:

- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- amortization of intangible assets;
- changes in our business model and margins;
- research and development write-offs; and
- other acquisition-related expenses.

In addition, we have limited experience with respect to negotiating an acquisition and operating an acquired business. If future acquisitions disrupt our operations, our business may suffer.

We depend on a limited number of key personnel who would be difficult to replace. If we lose the services of these individuals, our business will be harmed.

Because our market is new and evolving, the success of our business depends in large part upon the continuing contributions of our senior management. Specifically, continued growth and success largely depend on the managerial and technical skills of Monica Iancu, our President and Chief Executive Officer and one of our founders, and other members of senior management. Because the demand for highly qualified senior personnel exceeds the supply of this type of personnel, it will be difficult to replace members of our senior management if one or more of them were to leave us. If either Mrs. Iancu or other members of the senior management team are unable or unwilling to continue their employment with us, our business will be harmed.

Our success depends on our ability to continually develop and market new and more technologically advanced products and enhancements.

The market for our products and the services they are used to support is characterized by:

- rapid technological advances like the development of new standards for communications protocols;
- frequent new service offerings and enhancements by our customers, such as value-added IP-based services and new rating plans; and
- changing customer needs.

We believe that our future success will largely depend upon our ability to continue to enhance our existing products and successfully develop and market new products on a cost-effective and timely basis. We cannot assure you that we will be successful in developing and marketing new products that respond adequately to technological change. Our failure to do so would have a material adverse effect on our ability to market our own products.

If we are unable to adequately protect our intellectual property or become subject to a claim of infringement, our business may be materially adversely affected.

Our success and ability to compete depend substantially upon our internally developed or acquired technology. Any misappropriation of our technology could seriously harm our business. In order to protect our technology and products, we rely on a combination of trade secret, copyright and trademark law. Despite our efforts to protect our intellectual property rights, unauthorized parties may attempt to copy or otherwise obtain and use our software or technology or to develop software with the same functionality. Policing unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent misappropriation, particularly in foreign countries where the laws may not protect our intellectual property rights as fully as in the United States.

If anyone asserts a claim against us relating to proprietary technology or information, we might seek to license his intellectual property or to develop non-infringing technology. We might not be able to obtain a license on commercially reasonable terms or on any terms. Alternatively, our efforts to develop non-infringing technology could be unsuccessful. Our failure to obtain the necessary licenses or other right or to develop non-infringing technology could prevent us from selling our software and could therefore seriously harm our business.

Breaches in the security of the data collected by our systems could adversely affect our reputation and hurt our business.

Customers rely on third-party security features to protect privacy and integrity of customer data. Our products may be vulnerable to breaches in security due to failures in the security mechanisms, the operating system, the hardware platform or the networks linked to the platform. All our solutions provide web access to information, presenting additional security issues for our customers. Security vulnerabilities could jeopardize the security of information stored in and transmitted through the computer systems of our customers. A party that is able to circumvent our security mechanisms could misappropriate proprietary information or cause interruptions in the operations of our customers. Security breaches could damage our reputation and product acceptance would be significantly harmed, which would cause our business to suffer.

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

As an Israeli company subject to U.S. federal securities laws, we spend a significant amount of management time and resources to comply with laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations, Nasdaq listing rules and the Israeli Companies Law. In connection with our compliance with Section 404 and the other applicable provisions of the Sarbanes-Oxley Act, our management and other personnel devote a substantial amount of time, and we may need to hire additional accounting and financial staff, to assure that we continue to comply with these requirements. There is no guarantee that these efforts will result in management assurance that our internal control over financial reporting is adequate in future periods. If our internal controls are found to be ineffective in future periods, it could harm our operations, financial reporting or financial results.

## Risks Relating to the Market of our Ordinary Shares

Our share price has fluctuated and could continue to fluctuate significantly.

The market for our ordinary shares, as well as the prices of shares of other technology companies, has been volatile. The price of our ordinary shares has fluctuated significantly since our initial public offering in August 2000. A number of factors, many of which are beyond our control, may cause the market price of our ordinary shares to fluctuate significantly, such as:

- fluctuations in our quarterly revenues and earnings and those of our publicly held competitors;
- shortfalls in our operating results from the levels forecast by securities analysts;
- public announcements concerning us or our competitors;
- changes in pricing policies by us or our competitors;
- market conditions in our industry; and
- the general state of the securities market (particularly the technology sector).

We do not control these matters and any of them may adversely affect our share price. In addition, trading in shares of companies listed on the Nasdaq Global Market in general and trading in shares of technology companies in particular has been subjected to extreme price and volume fluctuations that have been unrelated or disproportionate to operating performance. These broad market and industry factors may depress our share price, regardless of our actual operating results.

Substantial sales of our ordinary shares could adversely affect our share price.

Sales of a substantial number of our ordinary shares could adversely affect the market price of our ordinary shares. Given the likely volatility that exists for our ordinary shares, such sales could cause the market price of our ordinary shares to decline.

As of April 1, 2012, we had 18,769,918 outstanding ordinary shares, which were freely tradable without restriction or further registration under the federal securities laws unless held by our “affiliates”, as that term is defined in Rule 144 under the Securities Act. As of April 1, 2012, there were outstanding options to purchase a total of 677,200 ordinary shares, of which 229,700 were vested. We have filed registration statements on Form S-8 covering the ordinary shares issuable upon the exercise of options under our 1998 and 2000 stock option plans, at which time these shares will be immediately available for sale in the public market, subject to the terms of the related options. We plan to file a new registration statement on Form S-8 covering the ordinary shares issuable upon the exercise of options under our 2011 share incentive plan.

Risks Relating to Our Location in Israel

Potential political, economic and military instability in Israel may harm our operating results.

We are organized under the laws of the State of Israel and a substantial portion of our assets and our principal operations, are located in Israel. Accordingly, our operations, financial position and operating results are directly influenced by economic, political and military conditions in and relating to Israel. Since the establishment of the State of Israel in 1948, a condition of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a high level of violence between Israel and the Palestinians which has strained Israel's relationship with its Arab citizens, Arab countries and, to some extent, with other countries around the world. Recent political events in various countries in the Middle East have shaken the stability of those countries and could lead to a deterioration in their relations with Israel. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in the region, such as Hamas in Gaza and Hezbollah in Lebanon. This situation may potentially escalate in the future to violent events which may affect Israel and us. Any armed conflicts or political instability in the region could negatively affect business conditions and harm our results of operations. We cannot predict the effect on the region of the increase in the degree of violence between Israel and the Palestinians. Furthermore, several countries and trade groups restrict business with Israel and Israeli companies, and additional countries and trade groups may restrict doing business with Israel and Israeli companies for political reasons. These restrictive laws and policies may seriously harm our operating results, financial condition or the expansion of our business. In addition, the current situation in Israel could adversely affect our operations if our customers and/or strategic allies believe that instability in the region could affect our ability to fulfill our commitments.

We currently participate in or receive tax benefits from government programs. These programs require us to meet certain conditions and these programs and benefits may be terminated or reduced in the future.

We receive tax benefits under Israeli law for capital investments, the Law for Encouragement of Capital Investments, 1959, as amended, or the Investments Law, that are designated as "Approved Enterprises". To maintain our eligibility for these tax benefits, we must continue to meet several conditions including making required investments in fixed assets. If we fail to comply with these conditions in the future, the tax benefits received could be cancelled. The termination or reduction of the tax benefits under the Investments Law could seriously harm our business, financial condition and operating results. For more information about Approved Enterprises, see Item 10.E "Taxation – Law for the Encouragement of Capital Investments, 1959" and Note 8 to our financial statements, which are incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012.

Because we have received grants from the Office of the Chief Scientist, we are subject to on-going restrictions that limit the transferability of our funded technology and of our right to manufacture outside of Israel any products developed with such technology, and certain of our large shareholders are required to undertake to observe such restrictions.

We have received grants in the past from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor. According to Israeli law, generally, any products developed with grants from the Office of the Chief Scientist are required to be manufactured in Israel, unless we obtain prior approval of a governmental committee. In addition, we are prohibited from transferring out of Israel the know-how developed with these grants, without the prior approval of a governmental committee. Approval is not required for the sale or export of any products resulting from the funded know-how. Any shareholder who becomes a controlling shareholder of our company or any non-Israeli who becomes a direct holder of 5% or more of our outstanding ordinary shares will be required to notify the Office of the Chief Scientist and to undertake to observe the law governing the grant programs of the Office of the Chief Scientist, the principal restrictions of which are described above in this paragraph.

It may be difficult to enforce a U.S. judgment against us, our officers and directors or to assert U.S. securities laws claims in Israel.

We are incorporated in the State of Israel. Substantially most of our executive officers and directors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. We have been informed by our legal counsel in Israel that it may be difficult to bring original actions in Israel to enforce civil liabilities under the Securities Act and the Exchange Act. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing these matters.

Subject to specified time limitations and legal procedures, under the rules of private international law currently prevailing in Israel, Israeli courts may enforce a United States final judgment in a civil matter, including judgments based upon the civil liability provisions of the U.S. securities laws and including a monetary or compensatory judgment in a non-civil matter, provided that:

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

adequate service of process has been effected and the defendant has had a reasonable opportunity to present his arguments and evidence;

the judgment and the enforcement thereof are not contrary to the law, public policy, security or sovereignty of the State of Israel;

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

an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the United States court.

Therefore, it may be difficult for a shareholder, or any other person or entity, to collect a judgment obtained in the United States against us or any of these persons, or to effect service of process upon these persons in the United States.

Provisions of Israeli law and our articles of association may delay, prevent or make difficult a change of control and therefore may depress the price of our stock.

Some of the provisions of our articles of association and Israeli law could, together or separately:

- discourage potential acquisition proposals;
- delay or prevent a change in control; and
- limit the price that investors might be willing to pay in the future for our ordinary shares.

In particular, our articles of association provide that our board of directors will be divided into three classes that serve staggered three-year terms and authorize our board of directors to adopt protective measures to prevent or delay a coercive takeover, including without limitation the adoption of a “Shareholder Rights Plan”. In addition, Israeli corporate law regulates mergers and acquisitions of shares through tender offers, requires approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. See Item 10.B “Memorandum and Articles of Associations- Mergers and Acquisitions under Israeli Law.” Furthermore, Israeli tax law treats stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in another corporation to taxation prior to the sale of the shares received in such stock-for stock swap.

#### Item 4. Information on the Company

##### A. History and Development of the Company.

###### General

Our name is MIND C.T.I. Ltd. for both legal as well as commercial purposes. We were incorporated under the laws of the State of Israel on April 6, 1995 as a company with limited liability, and we are subject to the Israeli Companies Law, 1999 and the regulations promulgated thereunder. Our principal executive offices are located at Industrial Park, Building 7, Yoqneam 20692, Israel. Our telephone number is +972 4 993 6666. Our agent in the United States is MIND Software Inc. and its principal offices are located at 12520 Prosperity Drive, Suite 220, Silver Spring, MD 20904, USA.

###### Important Events in the Development of the Company

In January 2011, we issued to EastLink (a new customer in Canada) a warrant to purchase 924,545 ordinary shares of MIND at an exercise price of \$2.48 per share (equal to the average closing price per share of MIND's ordinary shares on the NASDAQ Stock Market during the 30 trading day period immediately preceding the date of the issuance thereof). The Warrant is exercisable from time to time for a period of 18 months following the date of issuance thereof.

###### Principal Capital Expenditures

During 2009, 2010 and 2011, the aggregate cash amount of our capital expenditures were \$0.4 million, \$0.2 million and \$0.4 million, respectively. These expenditures were principally for the purchase of property and other equipment. We currently have no material commitments for capital expenditures.

## B. Business Overview

### Overview

We develop, manufacture and market real-time and off-line billing and customer care software for various types of communication providers, including traditional wireline and wireless, voice over IP, or VoIP, and broadband IP network operators, WiMAX operators, cable operators, 3G operators and mobile virtual network operators, or MVNOs.

Our convergent billing and customer care solution supports multiple services, including voice, data and content services as well as both prepaid and postpaid payment models in a single platform. Prepaid subscribers can enjoy the full range of services offered by the provider, with their special bundles, rating plans and limits. The prepaid solution authorizes each service and controls each session in real time, taking care that the balance is not exceeded. Postpaid subscribers, including credit-limited and non-limited, retail or business customers, represent the loyal and the higher average revenue per user, or ARPU, market. All services used by a postpaid subscriber appear in a single bill, which includes all charges, including one-time, recurring and usage-related charges. Our billing solution is unique as it includes our own integrated real-time mediation product that provides interfaces with IP, Intelligent Networks, or IN, and traditional telecommunication equipment, as well as our own point-of-sale solution.

Our billing and customer care solution includes a powerful workflow engine to support the creation and execution of business processes such as order management, trouble ticket and debt collection. It also includes an integral point of sale solution that covers all dealer, store and cashier management and sales processes. The MIND solution introduces multi-layered architecture supporting real-time distributed processing, achieving performance, scalability and high availability. It uses an open architecture, including Service Oriented Architecture (SOA) and Document Oriented Architecture (DOA), thus enabling fast and seamless integration with other systems and third party applications. The MIND solution is built using standardized best-of-breed object-oriented technologies such as Java and XML, and it is J2EE compatible as it is powered by a commercial application server.

We also provide professional services, primarily to our billing and customer care customers, consisting of installation, turnkey project implementation services, customer support, training and maintenance services, customization and project management. Our professional services also include enhanced support options, known as managed services, which are mainly offered to customers in the United States and Europe and are performed from our offices. These managed services include performing day to day billing operational tasks.

In addition to our billing and customer care solutions, we offer call management systems used by organizations for call accounting, telecom expense management, traffic analysis and fraud detection. Our enterprise software product has been installed on about 20,000 switches around the world, for traditional telephony, for IP switches and hybrid networks. Our latest product, PhonEX-ONE, delivers one unified solution for all voice communication expenses including traditional, IP and mobile telephony. The flexible and scalable architecture of PhonEX-ONE meets the needs of large enterprises, supporting an unlimited number of extensions and sites, it introduces full functionality through a web browser, based on Microsoft SQL database and enhanced by the advanced ASP.NET technology.

Our Market Opportunity

Billing and Customer Care Industry

Billing and customer care are critical to telecommunications service providers as they enable them to track and bill for usage, manage revenues and customer relations, and launch, deploy and charge new services, marketing programs and rate plans. The need for comprehensive billing solutions is driven by the market trend that requires service providers to introduce new services, to be innovative in creating new product offerings and to optimize business processes for maximum efficiency. We provide tier 2 and tier 3 service providers with flexible, easy to deploy, convergent and scalable billing solutions.

From time to time, telecommunications service providers initiate searches for billing solutions to replace existing ones in order to offer additional services, reduce costs and improve service.

Also, from time to time, new providers surface and introduce new offerings to the market or try to attract a specific targeted customer base. They build new infrastructure or resell traffic and initiate searches for billing solutions.

An additional market opportunity is the trend towards all-IP networks, offering multiple next generation services. New billing solutions are required to enable the new services, and we are well positioned to support this need. As a pioneer in VoIP billing since 1997, we have the experience and the solution portfolio that is proven to be capable of delivering these technically demanding projects for all-IP networks.

#### Mobile Market

The two niches in the mobile market in which we see opportunities are the rural mobile carriers market in the United States and the MVNO (Mobile Virtual Network Operator) market. We have a number of such carriers as customers and we are focused on delivering solutions that address these particular markets.

#### Voice over IP Industry

Many service providers are moving towards networks in which IP-based equipment will carry a large proportion, if not all, of their traffic. These next generation networks, or NGNs, offer cost savings over traditional switched networks, as well as the potential to offer new services like VoIP. We have a strong reputation in areas such as mediation and VoIP billing, and our products are designed to work with NGNs.

Providers of multiple IP-based services typically require billing and customer care products that can handle authentication, authorization and accounting needs in real-time in order to determine the types of services to which the subscriber is entitled, as well as any applicable limits to the availability of the services. This real-time functionality is particularly important for prepaid billing plans. Finally, billing and customer care software products need to be easily adaptable to changes in the size and configuration of an IP provider's system, to new products and services and to enable rapid growth in subscriber base. Our proven solutions cover all these needs, as described below.

#### Our Billing and Customer Care Solution

We develop, market and support real-time and off-line, scalable billing and customer care software, including mediation and rating, for providers of voice, data and content services that are designed to meet their complex, mission-critical provisioning, authentication, authorization, accounting and reporting needs. Our billing and customer care software provides our customers with the following benefits:

*Real-Time Solution.* Service providers require a system that enables authentication, authorization and accounting and, if needed, cut-off, all in real-time. We believe that the MIND solution is one of the few billing and customer care products that offers real-time functionality for both prepaid and postpaid billing plans, and that has a real-time rating engine able to support rating of voice, data and content services simultaneously;

*Mediation and Service Fulfillment.* IP and traditional networks that can offer voice, data, video and content services are based on various network elements each of which generates billable information. We believe that the MIND solution is one of the few billing and customer care products that provide real-time collection and correlation of various events from multiple sources that relate to the same session and convert them into billable records. In addition, the MIND solution enables end-to-end automated flow for service creation and activation, meaning that from the order for service handled by the customer care representative until the service activation, the activities that need to be completed are automatically fulfilled by MIND;

*Scalability.* Our billing solutions are designed to be easily adapted to changes in the size and configuration of a service provider's network. They enable the network of a service provider to grow from accommodating a small number of subscribers to a large number of subscribers, primarily through the addition of hardware. This feature allows a service provider to expand its infrastructure and its subscriber base without the need to redesign or replace its billing and customer care software. The scalability of our software is important since many service providers begin with a relatively small subscriber base and experience rapid growth. For example, we designed and provided a billing and customer care solution for China Unicom, which started offering Voice over IP services in 1999. When China Unicom first deployed our software in May 1999, it was capable of supporting one million users. Our software was upgraded to support five million users in November 1999, 20 million users in June 2000 and 30 million users in June 2001. Increases in the number of users were accomplished without the need to modify or replace our installed software;

*Improved Time to Market.* Our billing solutions are modular, extensible software products based on software architecture designed for easy adaptability and implementation. These features allow each of our customers to tailor our products to meet their individual needs in terms of the number of subscribers serviced and the variety of services provided. In addition our products can be customized relatively quickly, enabling our customers to improve their time to market as they initially implement their networks and, later, as they add and modify the services they provide.

## Our Strategy

Our objective is to be a leader in the market for convergent billing and customer care software for tier 2 and tier 3 service providers and to maintain and increase profitability.

As we increase our focus on end-to-end billing solutions for tier 2 and tier 3 service providers, projects are now generally more complex in nature, with revenue recognized over longer periods. These factors typically extend the recognition period of both license and service revenue streams and have some balance sheet impacts. We consider this a normal and expected development for our business as it grows and matures. We have built a professional services team to support the growth in services offered to customers. Our long-term business model contemplates that licenses, maintenance and services will each represent approximately 30-40% of revenues and gross margins will be 60-70%. The key elements of our strategy to become a leader in the market for convergent billing and customer care software for tier 2 and tier 3 service providers include:



*Leverage our brand name recognition and technical expertise.* We introduced our billing and customer care software in 1997. We believe that our early position in the market and our reputation for offering high quality, reliable billing and customer care software has provided us with brand name recognition. We intend to leverage our reputation, brand name and recognition in the wireline and wireless markets;

*Maintain and expand our technological expertise.* We believe that our reputation in the market is due in large part to our technological expertise. We make significant investments in our research and development to continually enhance our products to meet the changing needs in the telecom industry. We intend to continue our commitment to technology, both to enhance our existing products and to develop new products for growing markets; and

*Expand professional services opportunities.* As our projects are of larger scale and as convergent service offerings become more complex, our customers increasingly require consulting services, especially for customization, as well as for project management, installation and training, technical support and maintenance. This provides us with the opportunity to increase our revenue base from existing customers. We have begun to capitalize on this opportunity and, as a result, fees from providing professional services have increased.

## Our Products and Services

### Billing and Customer Care Solutions

Our billing solutions include real-time and off-line mediation, provisioning, rating, billing and customer care software for voice, data, video and content services that meet the mission-critical needs of convergent IP, Wireline and Wireless service providers.

Our highly functional and adaptable products enable our customers to quickly deploy new services as well as to rapidly grow and add new services. Our solutions support both prepaid billing plans, in which customers prepay for the services, or postpaid billing plans, in which customers pay for the services after using them, on the basis of either limited or unlimited credit lines. The key functionalities of our solutions are as follows:

*Mediation.* Our mediation platform provides real-time and batch event collection interfacing with the voice, content, data, service delivery and routing network elements. It incorporates an intelligent processing engine to correlate, aggregate, merge and filter raw events into a single valuable usage event;

*Provisioning.* Provisioning involves setting up the ability of a subscriber to use services. The customer database includes information regarding customers' personal data, identification parameters and the services provided. This information can be provided in real time or on demand to any external system, such as network elements and legacy

billing solutions. The data provided includes service parameters such as enabled features and quantitative limits;

*Authentication.* Our real-time mediation module authenticates subscribers who connect to the network to use the service. Authentication is based on a number of methods, including user codes, passwords and caller line identification. The identification information is passed to the system, where the subscriber is authenticated and then permitted to use the service;

*Authorization.* Our systems authorize a particular usage, among other ways, by reviewing the type of service to determine whether the service is permitted or by reviewing the existing balance, pre-rating the service, using the rating engine described below and calculating the resulting cut-off parameters, if any, of the call or data session. Multiple parallel sessions are supported using our Balance manager, implementing quota allocation logic;

*Accounting.* When each session is completed, the rating engine described below is used to determine the amount to be charged to the subscriber and update the balance of the account in real-time. In addition, the usage detail records are stored for invoicing and reporting;

*Interconnect Billing.* The networks operated by our customers are typically interconnected with the networks of other telecommunications service providers. Interconnecting providers need to charge other providers for carrying each other's services over their networks. Our billing solutions generate reports that enable providers to bill for traffic and services that are being transported across their networks by other providers;

*Roaming.* Our solutions support the ability to provide services to visiting subscribers, on the one hand, and to roam both prepaid and postpaid subscribers in other networks, on the other hand. Our billing system provides the ability to define and manage the required roaming contract terms and the applicable tariff plan (IOT) for each roaming partner;

*Virtual Providers.* MIND offers a solution that enables a carrier to have resellers of traffic under different brand names, while it is still managed from the same billing platform, as a separated entity known as Virtual Provider. This model enables the carriers that own the networks, to lease its network equipment and its billing system to other providers.

*Multiple Services and Products Support.* Our billing solutions allow service providers to take advantage of their convergent networks by providing their customers with advanced voice, data, content and video services. The MIND Product Catalog allows service providers to bundle groups of services into tailor-made packages for which they can offer special rates, discounts and promotions. There are different classes of customers with respect to the availability, bandwidth, and quality of service requirements for these services. Our billing solutions offer an easy way to define these services, combine them into products, and rate each service and product differently;

*Rating.* Our billing solutions include a real-time and flexible rating engine that allows service providers to offer subscribers a wide variety of billing plans. This flexibility also allows service providers to set different tariff parameters. For example, our billing and customer care software can support different rates for various content and video streaming services and for different customer groups, rates based on the day of the week and time of the day and rates based on the origin and destination of the call. International service providers may define rates in different currencies using the product's multi-currency functionality. An unlimited number of free-unit and money-bundle is supported. Voucher based payment models are supported;



*Invoicing.* Our billing solutions include a high-capacity invoice server that handles all stages of invoice generation. It supports multiple billing cycles and bill production on demand. The invoice includes the customer details and information, such as usage details, monthly recurring charges, discounts and taxes, which are gathered throughout the billing period. This module creates the original bills to be printed locally or exported to bill printing service bureaus, using a customizable invoice layout.

*Account Receivables (A/R).* MINDBill manages all A/R activities, monitors the A/R status online and ensures a continuous cash flow. Multiple payment methods are supported by the system: cash, cheque, credit and debit cards, vouchers and more. MINDBill includes a flexible open API for payments interfaces to banks and credit card clearing houses. MINDBill has pre-integrated interfaces with major financial institutions, banks, clearinghouses and credit bureaus. The A/R includes the management of deposits life cycle, including payments and refunds, is easily done. Disputes can be managed and solved, resulting in the appropriate adjustments. MINDBill identifies the ageing debt for every open invoice according to the company policy for classifying to 30-60-90 days and initiating the built in debt collection process.

*Collection procedures.* The MINDBill collection facility provides flexibility in defining the collection policy using different collection paths. The solution provides full monitoring and control of the collection treatment (dunning process). It identifies customers with past due debts and ensures that they are handled in accordance with the company policy. This increases efficiency through the automation of the majority of the collection functions, and helps maximizing the success ratio. Automating the collection process utilizing the built in work flow engine enables operators to monitor the account receivables and ensure the collection of the entire revenue. All of this is achieved with operational efficiency streamlining the business processes that is fully integrated within the customer suit.

*Subscriber Web Interface.* Our billing solutions include a user-friendly subscriber web interface that allows subscribers to resolve billing inquiries themselves. Individual customers can obtain real time information about their account, including details of calls made that have not yet been invoiced, like the time, destination, length and cost of each call. The subscriber can also browse invoices, call details and payment history records. This feature is convenient for subscribers and efficient for service providers as it reduces service costs;

*Customer Support Representative Web Interface.* Our billing solutions include a user-friendly customer support representative web interface that allows operators of the system to perform customer care from any location. This feature is of particular significance to service providers who have remote operations centers and are required to provide support of their system in more than one location;

*Point of Sale (POS).* The POS is aimed mostly at the wireless retail market, enabling operators to offer their products and services in retail stores and manage the process within our enhanced solutions. POS is fully integrated into MIND Billing and Customer Care solutions, allowing operators to seamlessly offer services and accessories for new and existing customers and even to non-subscribers. POS integrates with external systems, such as credit card clearinghouses, external taxation engines and address validation systems. POS includes two modules working together:

*Resource Management Module* – a comprehensive inventory system that supports the operator’s chain of warehouses as well as his stores. It automates the management and tracking of the equipment sold to subscribers. The solution keeps track and manages the equipment by serial number, status, and location, providing the flow management from purchase orders, through the reception of the items shipped, the distribution of the items to the stores and the allocation of the items to the customers. It also supports inventory management functions such as on-hand-counts and catalogue management.

*Sales Module* – an easy to use cashier station that supports all service activations, phone and accessory sales through one interface on a single receipt. The Sales module enables all payment methods such as cash, check and credit card. It provides full control of the cashier devices such as cash drawer, credit card swipe, bar code reader and ribbon printer. Sales module interacts with the Resource Management module to show the sales clerk available items for sale in the store warehouse, to assign sold items to customer accounts and to enable track of items, such as returns and repairs.

*Business Processes Environment.* Customer care and billing processes are one of the most significant practices to drive business performance. These processes are fundamental for bringing innovative and competitive ways of delivering products and services to market. MIND’s automated business processes engine allows operators to meet the challenges they confront in today’s business environment. The business processes workflow implemented by the engine provides business intelligence behind day-to-day operations. The engine also automates the interaction with network elements and third party software. This is done in accordance with a uniquely defined set of business rules determined by the customer. MIND is offering in its deployments tailored, fully automated, order management processes, trouble tickets and debt collection processes.

The flexible and robust account creation order management process handles the orders from the customer’s contact, through registration, package selection, provisioning and activation. The order management process involves different users from various departments (such as supervisor approval of the contract and technician test), integration with external legacy systems (such as inventory), interaction with third party services (such as address validation) and more. MINDBill uses its inherent workflow capabilities to tailor an order management process that meets the operator’s business model;

*Call Management and Traffic Analysis Reports (CMS module).* The CMS module allows service providers to generate reports and graphic analyses of usage activity. These reports contain information regarding peak hours, usage loads to different destinations, the number of sessions per minute for a specific gateway or group of gateways,

the duration of sessions and other parameters. These features enable service providers to analyze subscriber behavior and use the information to improve their marketing and business development strategies. In addition, the traffic analyses reports assist service providers in planning the growth and development of their networks;

*Fraud Detection.* Our billing solutions include a fraud detection tool that enables detection of “stolen” calls and telephone misuse. It detects, locates and warns of any suspicious activity by activating alarms. It is easily customized to suit the needs of each service provider and allows a provider to build fraud inquiries based on a defined set of parameters. When these specific parameters are violated, alarms at four different alarm levels may be activated. Different actions may be implemented at each level. For instance, the operator may be alerted to possible fraud via e-mail, fax, audio or visual alarms.

## Enterprise Software

Our enterprise products, known as PhonEX, MEIPS, PhonEX-Ten and PhonEX-ONE, are used by corporations for telecom expense management, call accounting, traffic analysis and fraud detection. PhonEX and MEIPS are call management systems that collect, record and store all call information in a customized database. The systems:

- allow customers to generate near real-time reports on the enterprise's telephone use;
- produce sophisticated reports and graphics for easy and effective analysis of call activity; and
- allow customers to allocate telephone expenses to specific departments, individual clients or projects.

These functions allow organizations to more effectively manage their telecommunications resources. The systems are easy to install and configure, user-friendly and compatible with any switchboard system, traditional or IP. The systems perform call management and traffic analysis as well as fraud management in the same manner as our billing solutions. In addition, the systems are multi-lingual and multi-currency, which means that reports can be generated in any currency defined in the system, or in two currencies simultaneously.

PhonEX-ONE, delivers one unified solution for management of all telecom expenses, including traditional voice, IP voice and data, and mobile telephony. The flexible and scalable architecture of PhonEX-ONE meets the needs of large enterprises, supporting an unlimited number of extensions and sites. PhonEX-ONE provides tools to monitor, budget and manage voice traffic in order to achieve maximum control over telecommunication expenses. Some of its major advantages are:

*Fully web based solution.* The PhonEX-ONE fully web-based solution enables managers and users to conveniently access their telecom expenses management system anytime and from anywhere, using a web browser without decreasing their control over the traffic;

*User centric.* The PhonEX-ONE user-centric architecture provides a consolidated solution for the collection, analysis, reporting, and managing of all the telecommunication and data traffic expenses;

*Dashboard.* A visual representation of the most significant information regarding calls, a useful tool that helps administrators to get a quick and relevant image of the general system activity. The Dashboard can quickly provide - through its graphical and non-graphical monitors - a snapshot over the outgoing and incoming calls, traffic and exceptions as well as several top requested reports;

*Multi-site solution.* The PhonEX-ONE scales to support large multi-site organizations using voice and data equipment from multiple vendors. PhonEX-ONE supports complex hierarchies on which any employee can be associated to any branch of the organization and under a separate matrix to any corporate department;

*ASP.NET and MS-SQL database.* PhonEX-ONE is designed using the Microsoft .Net technology and has extensive configuration capabilities using XML files with server – client interaction;

*Certification by IP switch vendors.* PhonEX-ONE is interoperable and certified on a timely manner with new releases of IP switch vendors, including Cisco and Microsoft;

*Enhanced security.* PhonEX-ONE security management includes user authentication, security group restrictions, event log monitoring and encryption methodology of data base entries. This management tool enables a secure and easy control over the system;

*Modular architecture supporting high scalability.* The PhonEX-ONE's scalable system architecture supports an unlimited number of sites and extensions;

*Guard and Alerter.* The PhonEX-ONE Guard and Alerter provide sophisticated tools for fraud prevention, alerting on phone misuse, budget surpass, possible toll fraud or other abnormal behaviors within the organization; and

*Multilingual and multicurrency.* The built in support of multiple languages and multiple currencies enables telecom expense management for multinational organizations.

We intend to further develop and market these products as the emerging market for Voice over IP systems for enterprises grows.

#### Professional Services

We provide professional services to our customers, consisting primarily of project management, customization, installations, customer support, training and maintenance services. As our projects become more complex, more customers require customization services to add specialized features to their systems. We typically incorporate additional or specialized features developed for a particular customer into future versions of our products. We also offer enhanced support options, called managed services, which are mainly offered to customers in the United States and Europe and are performed from our offices. The managed services include performing day to day billing operational tasks. The managed services contracts are usually for a term of three to five years and are paid on a monthly basis.



## Technology

Our software products are based on an open architecture, which was developed using industry standard application server programming interfaces that enables it to readily integrate with other software applications. These application program interfaces create an object-oriented, multi-layered architecture that supports a distributed environment. Our object-oriented technology enables the design and implementation of software utilizing reusable business objects rather than complex procedural codes. Our layered architecture organizes these business objects to optimize the interface between the user and the application. We implement our software in a distributed configuration. This allows various modules to be installed on different servers to support the system's scalability and security. We believe that our technology allows us to offer products with the following benefits:

fast integration and interoperability with telecommunications equipment of major manufacturers, legacy systems and external software;

modular architecture that allows our products to be easily scalable and enables us to customize our software relatively quickly;

reliable products that support high availability of the service for mission-critical applications. Our automatic fail-over mechanism ensures minimal loss of service in case of a component failure; and

security at all levels of the architecture. Each user of the system may be assigned to different security groups. Service providers are therefore able to determine and audit access to the system. In addition, firewalls can be installed to prevent unauthorized access to the system.

Our software products are based on multiple-tier architecture, consisting of the following tiers:

**Client Application Tier:** This is the top tier graphic user interface between the user and the application. It includes client applications for customer registration, customer care and billing administration. In addition, it includes Web service interfaces that enable external applications to interact with the business tier;

**Business Object Tier:** This tier includes the business logic and rules of the system. This tier manages accounts, services, events and tariffs. It includes an object request broker that facilitates the transfer of information requested by the client application tier from the database tier;

**Database Tier:** This tier includes the Oracle database server and management software where the actual billing and customer care information is stored.

## Sales and Marketing

### Sales

### Billing and Customer Care Solutions

We conduct our sales and marketing activities primarily directly as well as through our marketing alliances with leading network equipment vendors and systems integrators. These marketing allies and resellers provide us with a global extension of our direct sales force and are a significant source of leads and referrals. We also engage in joint marketing activities with our allies, including joint responses to requests for proposals, sharing booths in trade shows, distributing each others' marketing information and cross links and references to web sites. We believe that these relationships also help validate our technology and facilitate broad market acceptance of our software.

Our contracts with our marketing allies, distributors and resellers are non-exclusive, do not contain minimum sales or marketing performance requirements and may be terminated at any time with notice.

## Enterprise Software

We conduct our sales and marketing activities primarily directly, by our sales force located in the MIND offices in the United States, the United Kingdom and Israel, as well as through appointed distributors and resellers through out the world. We engage with our system integrators and PBX equipment vendors for global marketing activities and responses to tenders.

## Marketing

Our marketing programs are focused on creating awareness, interest and preference for our products and services. We engage in a variety of marketing activities, including:

- participating in industry trade shows and special events;
- conducting ongoing public and press relations programs; and
- conducting training seminars for vendors and system integrators.

## Principal Markets

The following table shows our revenues for each of the past three years classified by activity and geographic region.

	Years ended December 31,		
	(in thousands of US \$)		
	2009	2010	2011
The Americas (total)	7,713	9,137	9,455
Sale of Licenses	3,003	2,719	1,366
Services	4,710	6,418	8,089
Asia Pacific and Africa (total)	719	1,907	1,222
Sale of Licenses	324	910	510
Services	395	997	712
Europe (total)	8,319	7,789	6,685
Sale of Licenses	2,498	2,564	2,565

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Services	5,821	5,225	4,120
Israel (total)	823	1,053	1,551
Sale of Licenses	310	360	713
Services	513	693	838
Total	17,574	19,886	18,913
Sale of Licenses	6,135	6,553	5,154
Services	11,439	13,333	13,759

## Customers

### Billing and Customer Care Solutions

Our billing and customer care solutions have been installed for a large base of customers worldwide, including:

traditional telecommunications service providers that also offer IP services including VoIP or/and data, such as China United Telecommunications Corp. (China Unicom), Romtelecom S.A., Singapore Telecommunications Limited (SingTel) and Sri Lanka Telecom;

- traditional wireline telephony providers, such as Moldtelecom, and SMTC;

- wireless telephony providers, such as KDDI America, Inc., Mobi PCS, Inc., and Revol;

- cable providers that also offer voice services , such as Megacable and EastLink;

- Mobile Virtual Network Enablers (MVNEs) such as Pelephone Telecommunications Ltd; and

- MVNOs, such as Viaero and Alon Cellular.

### Enterprise Software

Our enterprise software has been installed on about 20,000 switches around the world, for customers that include international banking firms, government agencies and other small to very large organizations.

## Competition

### Billing and Customer Care Solutions

Competition in the market for billing and customer care software is intense and we expect competition to continue to be strong. We compete with many local companies and worldwide companies such as Amdocs (after the acquisition of Sigvalue Technologies by Amdocs), Comverse (after the acquisition of the Global Software Services division of CSG Systems International by Comverse) and Oracle Corporation (after the acquisition of Portal Software by Oracle).

We believe that our competitive advantage is based on:

- our ability to rapidly deploy a complete turn-key product based solution;
- our solutions' functionality, which includes billing, customer care, point-of-sale, mediation, provisioning, rating for multiple services and prepaid IP functionality;
- our proven platform and our many years of wireless and IP experience to satisfy customer requirements; and
- our flexibility to meet customer requirements in a short time frame.

Some of our competitors have greater financial, technical, sales, marketing and other resources and greater name recognition than we do. Some of our competitors have lower cost structure and compete with us on pricing. Current and potential competitors have established, and may establish in the future, cooperative relationships among themselves or with third parties to increase their ability to address the needs of prospective customers. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share and their solutions could achieve greater market acceptance than our solutions.

## Enterprise Software

Our competitors in the market for enterprise software products are mainly local companies, especially in the United States and the United Kingdom. To compete effectively, companies must be able to offer adequate technical support and ongoing product development and customization services. In addition, multinational companies prefer call accounting systems that can be installed at their various offices throughout the world, and therefore require call accounting products that are multilingual and support the local telecommunication requirements. The principal factors upon which we compete are customer support, ease of use, compatibility with major switchboard systems and IP switches and the multi-lingual and multi-currency nature of our system.

### C. Organizational Structure

Set forth below is a list of our significant subsidiaries:

- MIND Software Limited, a wholly owned subsidiary, incorporated in the United Kingdom;
- MIND Software Inc. (formerly Sentori Inc.), a wholly owned subsidiary, incorporated in the State of Delaware;
- MIND Software SRL., a wholly owned subsidiary, incorporated in Romania; and
- Dirot Comp SRL., a wholly owned subsidiary, incorporated in Romania.

### D. Property, Plant and Equipment

Our headquarters are located in Yoqneam, Israel, approximately 50 miles north of Tel Aviv. We lease approximately 15,000 square feet at our Yoqneam headquarters. We also lease approximately 2,100 square feet of office space in Silver Spring, Maryland and approximately 24,000 square feet in Jassy, Romania. The office in Maryland is used primarily for supporting our customers in the United States, while the office in Jassy is used primarily for software development and for customer support. The office in Maryland is the group's headquarters in the Americas.

## Item 4A. Unresolved Staff Comments

Not applicable.

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Item 5. Operating and Financial Review and Prospects

The following discussion and analysis is based on and should be read in conjunction with our consolidated financial statements and the related notes thereto, which are incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012.

Overview

We were incorporated in Israel in 1995 and started providing our enterprise software products in that year. In 1997, we introduced our billing and customer care software for Voice over IP. We have enhanced our billing solutions since then to support multiple IP services, wireless and wireline carriers and multiple play (voice, data and content) service providers. In 2011, 78% of our revenues were derived from providing our billing and customer care software and 22% were derived from providing our enterprise software. In 2011, license fees represented 27% of our revenues and services represented 73%. In 2009, one customer accounted for approximately 11% of our total revenues. In 2010 and 2011, no customer accounted for 10% or more of our total revenues. We expect to continue to derive sizeable revenues from a small number of changing customers.

In August 2005, we acquired Sentori Inc., a leading provider of billing and customer care solutions to tier 3 and tier 2 wireless carriers and mobile virtual network operators, or MVNO's, mainly in the United States and the Caribbean. In October 2007, we acquired the U.K.-based Omni Consulting Company Limited, which provides billing and customer care software solutions in a service bureau mode, mainly to European carriers.

In 2009, we experienced a decrease in revenues driven primarily by the low number of new deals signed in 2008, which resulted in lower revenue recognition in 2009. In 2010, we experienced an increase in revenues over 2009 primarily driven by four new deals signed in 2009 for which the revenues were recognized mainly in 2010. In 2011, we experienced a decrease in revenues driven primarily by the loss of service bureau customers of our U.K. subsidiary, Mind Software Limited (formerly known as Omni).

In 2007, we recorded a \$15.2 million impairment charge with respect to our holding of an auction rate security (the "Security") in the principal amount of \$20.3 million. In 2008, we recorded a \$4.2 million impairment charge with respect to the Security, and in 2009 we recorded an additional \$0.9 million impairment charge with respect to the Security. The carrying value of the Security as of December 31, 2009 was nil.

In 2009, we recognized financial income of \$18.5 million due to a settlement with the investment firm that purchased the auction rate security for us. See below under Item 5.B - “Liquidity and Capital Resources” and Item 11 – “Quantitative and Qualitative Disclosures About Market Risk” for more information.

In July 2003, we adopted a dividend policy, according to which we declare, subject to specific board approval and applicable law, a dividend distribution once per year, in the amount of our net income from the previous year. In October 2010, our board of directors updated this policy slightly. The new policy changes only the amount to be distributed, the new amount being equal to our EBITDA plus financial income (expenses) minus taxes on income. Additionally the board approved dividend distributions in 2003, 2007, 2008, 2009, 2010 and 2011 that were subject to approvals from an Israeli Court in accordance with Section 303 of the Israeli Companies Law due to the fact that we did not have sufficient retained earnings, which court approvals were received. Since 2003, we distributed cash dividends of approximately \$2.61 per share to our shareholders: \$0.14 per share in 2003, \$0.13 per share in 2004, \$0.24 per share in 2005, \$0.14 per share in 2006, \$0.20 per share in 2007, \$0.20 per share in 2008, \$0.80 per share in 2009, \$0.20 per share in 2010, \$0.32 per share in 2011 and \$0.24 per share in 2012. The board decision to approve the annual distribution is based, among other factors, on our cash position at that time, potential acquisitions and future cash needs. The board may decide to discontinue the dividend distribution in whole or in part at any time.

In September 2008, our board of directors authorized a plan for the repurchase of up to 2,100,000 of our ordinary shares in the open market, in an amount in cash of up to \$2.8 million. As of December 31, 2008, we had repurchased 2,100,000 ordinary shares under the program at a total purchase price of approximately \$1.6 million, after getting an approval by an Israeli court in accordance to the Israeli Companies Law. In February 2009, our board of directors authorized additional repurchase transactions of our shares in the total amount of \$1.2 million pursuant to the 2008 repurchase plan. In November 2009, our board of directors authorized an additional plan for the repurchase of our shares in an amount of up to \$1.8 million. In January 2010, we applied for and in March 2010 we received Israeli court approval to repurchase our shares in the total amount of up to \$1.8 million. As of both December 31, 2009 and 2010, we purchased an aggregate amount of 3,165,092 ordinary shares at a total purchase price of \$2.8 million.

*Revenues.* We are paid license fees by our customers for the right to use our products, based on (1) traffic volume, which is measured by factors such as minutes per month, number of lines used, number of data sources and number of subscribers, and (2) the functionality of the system based on application modules that are added to the software. In relation to our professional services, other than maintenance services and managed services, we mainly quote a fixed price based on the type of service offered, estimated direct labor costs and the expenses that we will incur to provide these services. Fees for maintenance services are based on a fixed percentage of the license fee and are paid annually, quarterly or monthly. Fees for managed services are primarily based on the number of subscribers or customers business volume and are paid monthly.

We primarily use two business models when we sell our solutions, the license model and the managed services model. In the license model, the customer pays a one-time implementation fee, a one-time license fee for a perpetual license limited by the traffic metrics chosen by the customer, and additional fees to expand the chosen traffic metrics limitation. In addition, we are paid maintenance fees to renew periodically the maintenance agreement at the customer discretion. In the managed services model, the customer pays a one-time implementation fee, a monthly fee that includes a periodic license (right to use), maintenance and services fees, calculated by the metrics chosen by the customer (mainly, number of subscribers).

We provide a revenue breakdown for our billing and customer care software and our enterprise call management software. We believe that this information provides a better understanding of our performance and allows investors to make a more informed judgment about our business.

*Cost of Revenues.* The cost of revenues consists primarily of direct labor costs and overhead expenses related to software installation and maintenance. Cost of revenues also includes, among other things, software license fees to third parties, primarily Oracle, hardware, amortization of intangible assets, packaging and shipping costs.

*Research and Development Expenses.* Our research and development expenses consist primarily of compensation, overhead and related costs for research and development personnel and depreciation of testing and other equipment. Research and development costs related to software products are expensed as incurred until the “technological feasibility” of the product has been established. Because of the relatively short time period between “technological feasibility” and product release, no software development costs have been capitalized. We expect to continue to make substantial investments in research and development.

*Selling and Marketing Expenses.* Our selling and marketing expenses consist primarily of compensation, overhead and related costs for sales and marketing personnel, the operation of international sales offices, sales commissions, marketing programs, public relations, promotional materials, travel expenses, trade shows and exhibition expenses.

*General and Administrative Expenses.* Our general and administrative expenses consist primarily of compensation, overhead and related costs for executives and administrative personnel, professional fees, insurance, provisions for doubtful accounts and other general corporate expenses.

*Financial Income (Expenses), Net.* Our financial income (expenses), net consists mainly of interest earned on bank deposits and long term investments, gains and losses from the conversion of monetary balance sheet items denominated in non-dollar currencies into U.S. dollars, net of financing costs, and bank charges. In 2008 and 2009 the financial income (expenses) consisted mainly of impairments of our auction rate security and income that was recognized due to the settlement relating to such security in 2009.

*Taxes on Income.* See “—Corporate Tax Rate” below.

#### A. Operating Results

The following discussion of our results of operations for 2009, 2010 and 2011, including the percentage data in the following table, is based upon our statements of operations contained in our financial statements for those periods, and the related notes thereto, which are incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012:

	Years ended December 31, (% of revenues)		
	2009	2010	2011
Revenues	100.0 %	100.0 %	100.0 %
Cost of revenues	36.5	31.0	34.2
Gross profit	63.5	69.0	65.8
Research and development expenses	25.3	20.4	24.7
Selling, general and administrative expenses:			
Selling and marketing expenses	12.6	10.7	10.6
General and administrative expenses	13.2	7.8	9.7
Impairment of goodwill and intangible asset	-	5.0	-
Operating income	12.4	25.1	20.8
Financial income (expenses) – net	101.3	0.2	0.9
Income before taxes on income	113.7	25.3	21.7
Income tax expense (benefit)	1.1	0.9	(1.0 )
Net income	112.6	24.4	22.7

## Comparison of 2009, 2010 and 2011

*Revenues*

	Years ended December 31,			% Change 2010 vs. 2009	% Change 2011 vs. 2010
	(\$ in millions)				
	2009	2010	2011		
License sales	6.1	6.6	5.1	8.2	(22.7 )
Professional services	11.5	13.3	13.8	15.7	3.8
Total revenues	17.6	19.9	18.9	13.1	(5.0 )

Revenues in 2010 increased in comparison to 2009 by 13.1%. The increase was primarily attributed to four new deals signed in 2009 for which the revenues were recognized mainly in 2010. Revenues in 2011 decreased in comparison to 2010 by 5.0%. The decrease was primarily attributed to the decrease of approximately \$0.8 million in the revenues of Mind Software Limited (formerly known as Omni) due to the loss of service bureau customers. Revenues from our billing and customer care product solutions for service providers increased from \$15.1 million in 2009 to \$15.7 million in 2010 and decreased to \$14.8 million in 2011. The reasons for the changes in revenues from billing are similar to those for the changes in total revenues. Revenues from our enterprise products increased from \$2.5 million in 2009 to \$4.2 million in 2010. The increase was primarily attributed to the large deal signed in 2009 for which the revenues were recognized mainly in 2010 and improved sales of our enterprise products globally. Revenues from our enterprise products slightly decreased from \$4.2 million in 2010 to \$4.1 million in 2011. The decrease was caused by

the fact that 2010 revenue was uniquely high (because of the recognition of one large deal) and does not reflect the improved global sales of our enterprise products that occurred in 2011.

Revenues from professional services as a percentage of total revenues increased from 65% in 2009 to 67% in 2010 and further increased to 73% in 2011. As our projects are of a larger scale and as convergent service offerings become more complex, our customers increasingly require consulting services, especially for customization, as well as for project management, installation and training, technical support and maintenance. As a result, fees from professional services have increased.

The following table presents the geographic distribution of our revenues:

	Years ended December 31, (% of revenues)		
	2009	2010	2011
The Americas	43.9	45.9	50.0
Asia Pacific and Africa	4.1	9.6	6.5
Europe	47.3	39.2	35.3
Israel	4.7	5.3	8.2
Total	100.0 %	100.0 %	100.0 %

Our sales in Europe as a percentage of revenues decreased from 47.3% in 2009 to 39.2% in 2010 and further decreased to 35.3% in 2011 mainly due to loss of service bureau customers that were clients of our U.K. subsidiary, Mind Software Ltd. (formerly known as Omni). Our sales in the Americas as a percentage of revenues increased from 43.9% in 2009 to 45.9% in 2010 and further increased to 50.0% in 2011 mainly due to the new wins we had in the United States since 2009 and also due to the reduction in European sales. Our sales in Israel as a percentage of revenues increased from 5.3% in 2010 to 8.2% in 2011, mainly due to our first wins of billing projects in Israel; until 2011, our revenues in Israel were derived from our enterprise solutions only.

#### *Cost of Revenues*

	Years ended December 31,			% Change 2010 vs. 2009	% Change 2011 vs. 2010
	(\$ in millions)				
	2009	2010	2011		
Cost of sales of licenses	0.5	0.5	0.4	-	(20.0 )
Cost of services	5.9	5.7	6.1	(3.4 )	7.0
Total cost of revenues	6.4	6.2	6.5	(3.1 )	4.8

The decrease in the total cost of revenues and cost of services in 2010 compared to 2009 is mainly attributed to the fact that the cost of revenues in 2009 included one-time additional charges in the amount of \$0.8 million driven by the cancellation of projects for managed-services customers which went out of business, offset by the expected increase in cost in 2010 attributed to the increase in our revenues. The increase in total cost of revenues in 2011 by \$0.3 million compared with 2010 was due to increase in cost of services by \$0.4 million, mainly due to increase in labor related costs, offset by the decrease in cost of licenses by \$0.1 million that occurred due to the decrease in revenue from licenses.

Gross profit as a percentage of revenues increased from 63.5% in 2009 to 69.0% in 2010 and decreased to 65.8% in 2011. The increase in 2010 compared to 2009 was due to the cancellation of deferred revenue in the amount of \$0.5 million related to the cancelled projects which had not been recognized in the past that occurred in 2009. The decrease in 2011 compared to 2010 was due to the above-mentioned loss of service bureau customers (supported with relatively low cost of revenues) and a deduction from revenues of stock-based compensation granted to a new customer.

## Operating Expenses

	Years ended December 31,			% Change	% Change
	(\$ in millions)				
	2009	2010	2011	2010 vs. 2009	2011 vs. 2010
Research and development	4.4	4.0	4.7	(9.1 )	17.5
Selling and marketing	2.2	2.1	2.0	(4.5 )	(4.8 )
General and administrative	2.3	1.6	1.8	(30.4 )	12.5
Impairment of goodwill and another intangible asset	-	1.0	-	NA	NA
Total operating expenses	8.9	8.7	8.5	(2.2 )	(2.3 )

*Research and Development.* We make substantial investment in research and development to maintain our advanced technology and add functionality to our products. The decrease in our research and development expenses in 2010, compared to 2009, by 9.1% was primarily due to the decrease in the cost attributable to payroll and related expenses of our employees engaged in research and development resulting from a decrease in headcount in this department. The increase in our research and development expenses in 2011, compared to 2010, by 17.5% was primarily due to the increase in research and development related payroll expenses. The increase in payroll reflects the increase in the average salary, mainly in Romania, expansion in R&D personnel required to improve and expand our product offering, and the devaluation of the U.S. dollar in relation to the NIS or the Euro. Research and development expenses as a percentage of revenues decreased from 25.3% in 2009 to 20.4% in 2010 as the expense decreased by 9.1% and our revenue increased. Research and development expenses as a percentage of revenues increased from 20.4% in 2010 to 24.7% in 2011 as the result of the above-mentioned decrease in our revenues and the increase in the research and development expenses.

*Selling and Marketing Expenses.* Selling and marketing expenses slightly decreased from \$2.2 million in 2009 to \$2.1 million in 2010 and to \$2.0 million in 2011 mainly due to a decrease of approximately \$100,000 in amortization of intangible assets. Selling and marketing expenses as a percentage of revenues decreased from 12.6% in 2009 to 10.7% in 2010 as the revenue increased and the cost stayed almost flat as mentioned above. Selling and marketing expenses as a percentage of revenues stayed almost flat from 10.7% in 2010 to 10.6% in 2011 as both revenues and selling and marketing expenses decreased.



*General and Administrative Expenses.* General and administrative expenses decreased from \$2.3 million in 2009 to \$1.6 million in 2010 and increased to \$1.8 million in 2011. The decrease in 2010 in comparison to 2009 was mainly as a result of a successful collection of one customer's debt in 2010 which was recorded as a doubtful account in 2009. The increase in 2011 compared to 2010 reflects the above-mentioned one-time reduction in 2010 general and administrative expenses.

*Impairment of Goodwill and another Intangible Asset.* According to the impairment tests performed in 2009, no impairment was required. According to the impairment tests performed in 2010, we decided to write off the remaining balances of the goodwill and other intangible assets related to the Omni acquisition and recorded impairment charges of approximately \$1.0 million. No impairment of goodwill was required following the impairment test performed during the third quarter of 2011.

*Financial Income (Expenses).* In 2009, financial income amounted to \$17.8 million due to income in the amount of \$18.5 million that was recorded from the settlement relating to our auction rate security. The income was offset mainly by an impairment of our auction rate security in the amount of \$0.9 million. See Item 5.B "Liquidity and Capital Resources" and Item 11 "Quantitative and Qualitative Disclosures About Market Risk" for more information. In 2010, financial income consisted of interest income incurred mainly on short-term bank deposits in the amount of \$94,000, offset by negative currency exchange rate fluctuations and bank charges in the amount of \$45,000. In 2011, financial income consisted of interest income incurred mainly on short-term bank deposits and available for sale securities in the amount of approximately \$311,000, offset by negative currency exchange rate fluctuations, bank charges and realized loss on sale of available for sale securities in the amount of approximately \$140,000.

*Income Tax Expense (Benefit).* Income tax expense remains almost the same in 2010, compared to 2009, around \$200,000. In 2011 we had income tax benefit of \$185,000 due to an increase of deferred income taxes of \$277,000 offset by current taxes on income of \$92,000.

#### *Critical Accounting Policies*

To improve understanding of our financial statements, it is important to obtain some degree of familiarity with our critical or principal accounting policies. These policies are described in note 1 to the consolidated financial statements, which are incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012. We review our accounting policies annually to ensure that the financial statements developed, in part, on the basis of these accounting policies provide complete, accurate and transparent information concerning the financial condition of our company. As part of this process, we reviewed the selection and application of our critical accounting policies and financial disclosures as of December 31, 2011, and we believe that the consolidated financial statements present fairly, in all material respects, the consolidated financial position of our company as of that date.

In preparing our financial statements in accordance with generally accepted accounting policies in the United States of America, our management must often make estimates and assumptions which may affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures as of the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex, and consequently actual results may differ from those estimates. For any given individual estimate or assumption made by our management, there may be alternative estimates or assumptions which are also reasonable. However, we believe that given the facts and circumstances before our management at the time of making the relevant judgments, estimates or assumptions, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on the consolidated results of operations, financial position or liquidity for the periods presented in the consolidated financial statements.

We are also subject to risks and uncertainties that may cause actual results to differ from estimates and assumptions, such as changes in the economic environment, competition, customer claims, foreign exchange, taxation and governmental programs. Certain of these risks, uncertainties and assumptions are discussed under the heading “Forward-Looking Statements” and in Item 3.D “Risk Factors”.

We consider our most significant accounting policies to be those discussed below:

*Revenue Recognition.* We apply the provisions of Statement of ASC 985-605, "Revenue Recognition" (formerly SOP No. 97-2) and ASC 605-35, "Construction-Type and Production-Type Contracts" (formerly SOP No. 81-1), as follows:

*i) Sales of licenses:* Revenue from sale of products is recognized when delivery has occurred, persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collection is probable. If collection is not considered probable, revenue is recognized when the fee is collected. We generally do not grant a right of return on products sold to customers.

*ii) Services:* The services we provide consist of implementation, training, hardware installation, maintenance, support and project management. All services are priced on a fixed price basis and are recognized ratably over the period in which the services are provided except services which are recognized under the percentage-of-completion method as described below.

Products are mainly supplied with maintenance for a period of one year from delivery. When revenue on sale of the products is recognized, we defer a portion of the sales price and recognize it as maintenance revenue ratably over the above period. The portion of the sales price that is deferred is determined based on the fair value of the service as priced in transactions in which we render maintenance solely. Where vendor specific objective evidence for fair value cannot be determined, the entire sale is being recognized over the maintenance period. Where the services are considered essential to the functionality of the software products, both the software product revenue and the revenue related to the integration and implementation services are recognized under the percentage-of-completion method in accordance with ASC 605-35. We generally determine the percentage-of-completion by comparing the labor performed to date to the estimated total labor required to complete the project. When the estimate indicates that a loss will be incurred, such loss is recorded in the period identified. Significant judgments and estimates are involved in determining the percent complete of each contract. Different assumptions could yield materially different results.

*iii) Managed Services:* Revenues from managed services include a monthly fee for services and for right of use and are recorded as service revenues and license revenues, respectively. The monthly fee is based mainly on number of subscribers or customer’s business volume and the agreements include a minimum monthly charge. These revenues are

recognized on a monthly basis. Where installation services are sold together with a managed services contract, the installation services are recognized over the entire contract term, commencing with the deployment finalization.

*Provision for Doubtful Accounts.* The provision for doubtful accounts is for estimated losses resulting from the inability of our customers to make required payments. We regularly evaluate the adequacy of this provision by taking into account variables such as past experience, age of the receivable balance, and current economic conditions that may affect a customer's ability to pay. The use of different estimates or assumptions could produce different provision balances. If collection is not probable at the time the transaction is consummated, we do not recognize revenue until cash collection. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional provision for doubtful accounts may be required.

*Impairment of Goodwill and Other Intangible Assets.* We test our goodwill for impairment using a fair value approach at the reporting unit level, on an annual basis, or more frequently if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying value.

The goodwill impairment test is a two-step test. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that reporting unit, goodwill is not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, we must perform the second step in order to determine the implied fair value of the reporting unit's goodwill and compare it to the carrying value of the reporting unit's goodwill. The activities in the second step include valuing the tangible and intangible assets and liabilities of the impaired reporting unit based on their fair value and determining the fair value of the impaired reporting unit's goodwill based upon the residual of the summed identified tangible and intangible assets and liabilities.

In performing our impairment tests related to goodwill, we determine the fair value of our reporting units using the discounted cash flow approach. The discounted cash flow approach uses a reporting unit's projections of estimated operating results and cash flows and applies a weighted-average cost of capital that reflects current market conditions. The evaluation of goodwill requires us to use significant judgments and estimates, including but not limited to projected future revenues and expenses, changes in operating margins, cash flows, and estimates of future capital expenditures. Our estimates may differ from actual results due to, among other things, economic conditions, changes to our business model, or changes in operating performance. Significant differences between these estimates and actual results could result in future impairment charges and could materially affect our future financial results.

We perform annual testing for impairment of the goodwill during the third quarter of each year. As of September 30, 2011 the fair value of the reporting unit - Sentori exceeded its carrying value by 24%.

*Recently Issued Accounting Pronouncements.*

Recently issued accounting pronouncements are described in note 1 paragraph to the consolidated financial statements, which are incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on March 5, 2012.

### *Our Functional Currency*

The currency of the primary economic environment in which we operate is the U.S. dollar with the exception of our U.K. subsidiary. In 2011, approximately 92% of our revenues were derived from sales outside Israel, the majority of which were denominated in U.S. dollars. In addition, most of our marketing costs are incurred outside Israel, primarily in U.S. dollars. Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Balances in non-dollar currencies are remeasured into U.S. dollars using historical and current exchange rates for non-monetary and monetary balances, respectively. For non-dollar transactions and other items reflected in our income statements, the following exchange rates are used:

· for transactions, exchange rates at the transaction dates or average rates; and

for other items (derived from non-monetary balance sheet items such as depreciation and amortization or similar items), historical exchange rates.

The resulting currency transaction gains or losses are reported as financial income or expenses as appropriate.

The functional currency of our U.K. subsidiary is the Great British Pound. We consolidate this subsidiary's financial results into our financial statements, based on translation into U.S. dollars in accordance with ASC 830, "Foreign Currency Matters" (formerly SFAS No. 52). Assets and liabilities are translated at year-end exchange rates, while operating results items are translated at periodically average exchange rates during the year. Differences resulting from translation are presented in shareholders' equity.

### *Impact of Foreign Currency Fluctuations on Results of Operations*

The U.S. dollar cost of our operations is influenced by the extent to which any inflation in Israel is offset, on a lagging basis, or is not offset by the devaluation of the NIS in relation to the U.S. dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the U.S. dollar, companies experience increases in the U.S. dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS against the U.S. dollar, inflation in Israel or weakening of the U.S. dollar in global markets will have a negative effect on our profitability as we receive payment in U.S. dollars for most of our sales while we incur a portion of our expenses, principally salaries and related personnel expenses, in NIS.

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

Years ended December 31,	Israeli Inflation Rate	Israeli Devaluation Rate	Israel Inflation Adjusted for Devaluation
2007	3.4	(9.0 )	12.4
2008	3.8	(1.1 )	4.9
2009	3.9	(0.7 )	4.6
2010	2.7	(6.0 )	8.7
2011	2.2	7.7 )	(5.5 )

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

A devaluation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar amount of any of our expenses or liabilities which are payable in NIS, unless these expenses or payables are linked to the U.S. dollar. This devaluation also has the effect of decreasing the U.S. dollar value of any asset, which consists of NIS or receivables payable in NIS, unless the receivables are linked to the U.S. dollar. Conversely, any increase in the value of the NIS in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked NIS assets and the U.S. dollar amounts of any unlinked NIS liabilities and expenses. Because exchange rates between the NIS and the U.S. dollar fluctuate continuously, exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

#### B. Liquidity and Capital Resources

Since our inception, we have financed our operations mainly through cash generated by operations. We supplemented this source by two private rounds of equity financing, the first in 1997 (with a follow-on in 1999) and the second in 2000 and our initial public offering in 2000, which raised total net proceeds in the amount of \$44.3 million.

As of December 31, 2011, we had approximately \$13.9 million in cash and cash equivalents, and our working capital was \$17.0 million. In our opinion, our working capital is sufficient for our requirements for the foreseeable future.

*Net Cash Provided by/Used in Operating Activities.* Net cash provided by operating activities in 2009 was \$6.3 million, attributable to our net income of \$19.8 million, less \$18.5 million income from our auction rate security settlement, to non-cash related items, net, in the amount of \$2.0 million, and to a net decrease in operating assets and liabilities items in the amount of \$3.0 million. Net cash provided by operating activities in 2010 was \$6.3 million, attributable to our net income of \$4.9 million, non-cash related items, net, in the amount of \$1.8 million, and to a net increase in operating assets and liabilities items in the amount of \$0.4 million. Net cash provided by operating activities in 2011 was \$4.4 million, attributable to our net income of \$4.3 million, non-cash related items, net, in the amount of \$0.4 million, and to a net increase in operating assets and liabilities items in the amount of \$0.3 million.

The net cash provided by operating activities was \$6.3 million in 2010 and remained almost flat in comparison to 2009. The decrease in net cash provided by operating activities of \$1.9 million from 2010 to 2011 reflects mainly a decrease in our net income of \$0.6 million, a decrease in impairments of goodwill and intangible assets of \$1.0 million and a decrease in depreciation and amortization of \$0.3 million compared to 2010.



### *Net Operating Working Capital*

As of December 31, 2010, the net operating working capital was \$18.1 million compared with \$15.3 million as of December 31, 2009. The increase of \$2.8 million was mainly due to an increase in cash position in the amount of \$2.3 million. There was no material change in other operating assets and liabilities. As of December 31, 2011, the net operating working capital was \$17.0 million compared with \$18.1 million as of December 31, 2010. The decrease of \$1.1 million was mainly due to a decrease in cash and cash equivalents and other short term investments in the amount of \$1.9 million, offset by an increase of \$0.9 million in deferred cost of revenues.

### *Cash Deposits*

As of December 31, 2011, we had approximately \$4.3 million in bank deposits with maturities of between three and twelve months.

*Net Cash Provided by/Used in Investing Activities.* In 2009, we received proceeds in the amount of \$18.5 million as a result of the settlement relating to our auction rate security, and we invested \$2.2 million in short-term bank deposits. In 2010, our principal investment activities were the increase of our investments in short-term bank deposits by \$0.7 million and the use of \$0.2 million for capital expenditures. In 2011, we increased our investments in short-term bank deposits by \$1.4 million and used \$0.4 million for capital expenditures. In addition, in 2011, we purchased security bonds in the amount of \$2.5 million and we received \$1.4 million from selling part of them.

*Net Cash Provided by/Used in Financing Activities.* In 2009, our financing activities used \$16.0 million due to a cash dividend of \$14.8 million and the repurchase of shares in the amount of \$1.2 million. In 2010, our financing activities used \$3.6 million due to a cash dividend of \$3.7 million, offset by \$0.1 million in proceeds from the exercise of employee stock options. In 2011, our financing activities used \$5.6 million due to a cash dividend of \$6.0 million, offset by \$0.4 million in proceeds from the exercise of employee stock options.

*Capital Expenditures.* In 2009, the aggregate cash amount of our capital expenditures was \$0.4 million. In 2010, the aggregate cash amount of our capital expenditures was \$0.2 million, and in 2011 the aggregate cash amount of our capital expenditures was \$0.4 million. These expenditures were principally for the purchase of property and other equipment. Although we have no material commitments for capital expenditures, we anticipate an increase in capital expenditures if we decide to construct a building for our office in Romania or if we purchase or merge with companies or purchase assets in order to obtain complementary technology and to expand our product offerings, customer base and geographical presence.

*Cash Dividends.* Since 2003, we distributed aggregated cash dividends of approximately \$2.61 per share to our shareholders: \$0.14 per share in 2003, \$0.13 per share in 2004, \$0.24 per share in 2005, \$0.14 per share in 2006, \$0.20 per share in 2007, \$0.20 per share in 2008, \$0.80 per share in 2009, \$0.20 per share in 2010, \$0.32 per share in 2011 and \$0.24 per share in 2012. For information about our dividend policy, please see Item 8 “Financial Information - Dividend Policy.”

*Share Repurchase.* As of December 31, 2011, we have repurchased an aggregate amount of 3,165,092 ordinary shares, for a total consideration of approximately \$2.8 million. As of April 1, 2012, we have the authority to use additional \$1.8 million for share repurchases.

C. Research and Development, Patents and Licenses, etc.

We believe that significant investment in research and development is essential for maintaining and expanding our technological expertise in the market for billing and customer care software and to our strategy of being a leading provider of new and innovative convergent billing products. We work closely with our partners, customers and distribution channels, who provide significant feedback for product development and innovation.

We have invested significant time and resources to create a structured process for undertaking research and product development. We believe that the method that we use for our product development and testing is well suited for identifying market needs, addressing the activities required to release new products, and bringing development projects to market successfully. Our product development activities also include the release of new versions of our products. Although we expect to develop new products internally, we may, based upon timing and cost considerations, acquire or license technologies or products from third parties.

Our research and development personnel include engineers and software developers with experience in the development and design of billing and customer care software. As of December 31, 2011, our research and development department consisted of 212 employees out of a total of 319 employees.

D. Trend Information

Our billing and customer care solutions target tier 2 and tier 3 service providers. The need for comprehensive billing solutions is driven by the market trend that requires service providers to introduce new services more rapidly, to be innovative in creating new product offers and to optimize business processes for maximum efficiency. In this environment, flexible and stable billing software is seen as business critical. If a system fails, or service quality is degraded, it can be highly detrimental to both a carrier's ability to collect revenue and to its customer relations.

In our experience, the active markets lately are in the U.S. the rural mobile carriers that offer simple plans, mainly pay-as-you-go with either prepaid or pay-in-advance policies, the service providers worldwide that move towards IP networks and offer multiple services, and existing carriers that search for replacement of billing solutions as they diversify their offering and seek a convergent platform.

Integrating voice and data in enterprise switches (the IP private branch exchanges, or IP PBX's) is a trend in which we are participating. Our goal is to develop marketing and sales relationships with the vendors of IP PBX's such as Cisco Systems and Microsoft under which our enterprise software will be sold together with these vendors' systems. This requires us to develop new sales channels with the distributors of IP PBX's. This process is time consuming and requires the investment of some resources to conclude the necessary agreements and to certify and train these new

channel partners.

E. Off-balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

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## F. Tabular Disclosure of Contractual Obligations

Contractual Obligations	Payment due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations	0	0	0	0	0
Capital (Finance) Lease Obligations	0	0	0	0	0
Operating Lease Obligations	\$1,500,000	\$484,000	\$869,000	\$147,000	0
Purchase Obligations	0	0	0	0	0
Other Long-Term Liabilities Reflected on our Balance Sheet under U.S. GAAP	0	0	0	0	0
Total	\$1,500,000	\$484,000	\$869,000	\$147,000	0

## Item 6. Directors, Senior Management and Employees

## A. Directors and Senior Management

The following table sets forth certain information regarding our directors and executive officers as of the date of filing of this Annual Report:

Name	Age	Position
Monica Iancu	54	President and Chief Executive Officer
Aviram Cohen	35	Chief Financial Officer
Doron Segal	47	Vice President – Engineering and Chief Technology Officer
Tal Shain	44	Vice President – Professional Services
Danny Engle	43	Vice President – Sales for North America
Amnon Neubach	68	Director
Mihail Rotenberg	60	Director
Menahem Shalgi	62	Director
Rimon Ben – Shaoul	67	Director

The background of each of our directors and executive officers is as follows:

*Monica Iancu.* Mrs. Iancu founded MIND and has been President and Chief Executive Officer of our company since inception and until April 6, 2012, has also served as the Chairperson. Mrs. Iancu holds a B.Sc. degree in Computer Science and a Masters Degree in Telecommunications (with expertise in Voice and Data Integration over the Ethernet) from the Technion, Israel Institute of Technology.

*Aviram Cohen.* Mr. Cohen joined MIND as Controller in June 2006 and was promoted to Chief Financial Officer in 2010. Before joining us, he served as an auditor and accountant at Ernst & Young, (Haifa, Israel) from 2002. Mr. Cohen is a Certified Public Accountant and holds a B.A. degree in Accounting and Economics from Haifa University.

*Doron Segal.* Mr. Segal has served as our Chief Technology Officer since October 2004 and as our Vice President of Engineering since July 2007. Prior thereto, he worked for eight years at Comverse, at which he held a number of positions including Assistant Vice President with responsibility for product requirement definition and product level design. Mr. Segal holds a M.Sc. degree in Computer Science from Bar Ilan University and a B.Sc. degree in Physics, Mathematics & Computer Science from the Hebrew University.

*Tal Shain.* Mr. Shain joined us in June 1999 and has served as our Vice President of Professional Services since February 2006. Prior thereto, Mr. Shain served as our R&D Manager in Romania and Chief Architect. Mr. Shain holds a B.Sc. degree in Computer Engineering from the Technion, Israel Institute of Technology.

*Danny Engle.* Mr. Engle is Vice President of North American Sales for MIND Software Inc. (formerly Sentori Inc.). Mr. Engle joined Sentori in 2003 as Director of Sales, and later became Sentori's Vice President of North American Sales. Prior to joining Sentori, Mr. Engle was District Manager at Siebel Systems, a leading CRM solutions provider. Mr. Engle holds a B.S. degree in Business Administration from the University of Texas.

*Amnon Neubach.* Mr. Neubach has served as an external director of our company since February 2001. From 2001 to 2003, Mr. Neubach served as Chairman of the Board of Pelephone Communications Ltd. Mr. Neubach served as an economic consultant to several companies in the private sector since 1997. Currently Mr. Neubach serves as a director of Leumi Card Ltd., Direct Insurance Ltd and Athlone Ltd.. Mr. Neubach also serves as a director on the boards of various privately held companies and is the Chairman of Danpal Ltd and Gatton holdings. Mr. Neubach holds a B.A. degree in Economics and Business Administration and an M.A. degree in Economics, both from Bar Ilan University.

*Mihail Rotenberg.* Mr. Rotenberg has served as a director of our company since May 2008. He is the founder of BreezeCOM Ltd., which merged to become Alvarion Ltd., a wireless broadband pioneer and the leading provider of WiMAX. Mr. Rotenberg served as the Chief Executive Officer of BreezeCOM from 1993 to 2000. From 2000 to 2005 Mr. Rotenberg served as President and CEO of Accessnet SA, a wireless internet service provider in Romania, which was sold in 2005 to Clearwire Inc. Mr. Rotenberg holds a Ph.D. degree from Polytechnic University, Bucharest, Romania.

*Menahem Shalgi.* Mr. Shalgi has served as an external director of our company since April 2005. Mr. Shalgi served at Amdocs Ltd. (NYSE:DOX) as Vice President of Business Development and M&A from 1998 to 2003 and as Vice President and Executive Account Manager from 1993 to 1998. From 1991 to 1993, Mr. Shalgi served as the Chief Executive Officer of WIZTEC Ltd. Prior thereto, Mr. Shalgi served at Amdocs since 1985, at which he held a number of positions. Currently Mr. Shalgi serves as the chairman of Afterdox, an investment house in Israel, and also as a director of ClickSoftware Technologies Ltd. Mr. Shalgi holds a B.A. degree in Economics and Statistics from Tel-Aviv University and a M.Sc. degree in Computer Sciences from Weizmann Institute for Science.

*Rimon Ben-Shaoul.* Mr. Ben-Shaoul served as one of our directors since 2010 and from 2002 to 2008. Mr. Ben-Shaoul serves as the CEO of Polar Communications Ltd. since 2004 and also serves as the Chairman of T.A.T. Technologies Ltd. and of Grand Automotive Ltd. Mr. Ben-Shaoul served as director in BVR systems, serves as a member of the board of directors of NICE Systems Ltd. since 2001 and also serves as a director on the boards of several privately held companies. Mr. Ben-Shaoul holds an M.B.A. degree and a B.A. degree in Economics, both from Tel Aviv University

#### B. Compensation of Directors and Executive Officers

The aggregate direct remuneration paid to all persons who served in the capacity of director or executive officer during 2011 was approximately \$1.5 million, including approximately \$80,000 that was set aside for pension and retirement benefits. This does not include amounts expensed by us for automobiles made available to our officers or expenses, including business, travel, professional and business association dues and expenses, reimbursed to officers, and do not include equity based compensation expenses.

During 2011, we granted to our executive officers under our option plans options to purchase 28,000 ordinary shares at an average exercise price of \$1.939 per share, which expire in 2016.

Our shareholders in a meeting held on April 7, 2005, resolved to grant each of our five directors (at that time) options to purchase 18,000 ordinary shares. The exercise price of the options is \$3.82, which was equal to the per share closing price of our ordinary shares on the Nasdaq Global Market on the trading date immediately preceding the shareholders meeting approving the grant. The options vested in three equal annual installments on February 1, 2006, 2007 and 2008 and expired on February 8, 2012. On May 15, 2011, our board of directors resolved that each of our external directors will be entitled to receive an annual fee of NIS 53,500 (approximately \$15,000) and a participation fee of NIS 2,820 (approximately \$800) per meeting, which is equal to the maximum rate for companies of our size set forth in the regulations governing the compensation of external directors under the Israeli Companies Law. On September 27, 2011, the same payment to each non-executive director was approved on by the annual general meeting of our shareholders, and in addition our shareholders approved that the remuneration of those external directors who will be classified by the board as expert external directors will be 20% more than the remuneration of the ordinary external directors.



## C. Board Practices

### Board of Directors

Our board is divided into three classes of directors, denominated Class I, Class II and Class III. The term of Class I will expire in 2013, Class II in 2014 and Class III in 2012. Monica Iancu is a member of Class I, Mihail Rotenberg is a member of Class II and currently there is no director who is a member of Class III. At each annual general meeting of shareholders, directors will be elected by a simple majority of the votes cast for a three-year term to succeed the directors whose terms then expire. There is no legal limit on the number of terms that may be served by directors who are not external directors. Our external directors are not members of any class.

The initial term of an external director is three years and may be extended for up to two additional terms of three years. Thereafter, an external director may be reelected by our shareholders for additional periods of up to three years each in certain circumstances described below. Mr. Neubach was re-elected to a fourth term as an external director on June 28, 2010. Mr. Menahem Shalgi was re-elected to a third term as an external director on September 27, 2011. Mr. Rimon Ben-Shaoul was elected to a first term as an external director on June 28, 2010. Under the Companies Law, our board of directors must determine the minimum number of directors having financial and accounting experience, as defined in the regulations, which our board of directors should have. In determining the number of directors required to have such expertise, the board of directors must consider, among other things, the type and size of the company and the scope and complexity of its operations. Our board of directors has determined that we require one director with the requisite financial and accounting expertise and that Mr. Amnon Neubach has such expertise.

### External Directors

Under the Companies Law, companies incorporated under the laws of Israel whose shares are listed for trading on a stock exchange or have been offered to the public in or outside of Israel are required to appoint two external directors. External directors are required to possess professional qualifications or financial and accounting expertise as set out in regulations promulgated under the Companies Law. The Companies Law provides that a person may not be appointed as an external director (i) if the person or the person's relative or affiliate has, as of the date of the person's appointment to serve as an external director, or had, during the two years preceding that date, any affiliation with the company, a controlling shareholder thereof or their respective affiliates or (ii) in a company that does not have a 25% shareholder, if such person has an affiliation with any person who, at the time of appointment, is the chairman, the chief executive officer, the chief financial officer or a 5% shareholder of the company.

The term affiliation includes:

an employment relationship;

a business or professional relationship;

control; and

service as an office holder.

The Companies Law defines the term “office holder” of a company to include a director, the chief executive officer, the chief business manager, a vice president and any officer that reports directly to the chief executive officer.

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

Until the lapse of two years from termination of office, a company or its controlling shareholder may not give any direct or indirect benefit to the former external director.

As mentioned above, the initial term of an external director is three years and may be extended for up to two additional terms of three years. Thereafter, an external director may be reelected by our shareholders for additional periods of up to three years each only if our audit committee and our board of directors confirm that, in light of the external director's expertise and special contribution to the work of the board of directors and its committees, the reelection for such additional period is beneficial to us.

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

- at least a majority of the shares of non-controlling shareholders voted at the meeting vote in favor of the election; or
- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed two percent of the aggregate voting rights in the company.

Reelection of an external director may be effected through one of the following mechanisms:

· the board of directors proposed the reelection of the nominee and the election was approved by the shareholders by the majority required to appoint external directors for their initial term; or

· a shareholder holding 1% or more of the voting rights proposed the reelection of the nominee, and the reelection is approved by a majority of the votes cast by the shareholders of the company, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders, provided that the aggregate votes cast in favor of the reelection by such non-excluded shareholders constitute more than 2% of the voting rights in the company.

External directors may be removed from office only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company's board of directors

that exercises a power of the board of directors is required to include at least one external director, except for the audit committee, which is required to include all the external directors.

## Audit Committee

Under the Companies Law, our board of directors is required to appoint an audit committee, comprised of at least three directors, including all of the external directors. The members of the audit committee must satisfy certain independence standards under the Companies Law, and the chairman of the audit committee is required to be an external director. Our audit committee consists of all our external directors and Mr. Mihail Rotenberg.

Under the Companies Law, the roles of the audit committee include examining flaws in the management of the company's business, in consultation with the internal auditor and the company's independent accountants, suggesting remedial measures, approving specified related party transactions and assessing the company's internal audit system and the performance of its internal auditor.

The approval of the audit committee is required to effect specified actions and transactions with office holders, controlling shareholders and entities in which they have a personal interest. An audit committee may not approve an action or a transaction with related parties or with its office holders unless at the time of approval at least two external directors are serving as members of the audit committee and at least one of who was present at the meeting in which any approval was granted.

Under the Nasdaq rules, our audit committee assists the board in fulfilling its responsibility for oversight of the quality and integrity of our accounting, auditing and financial reporting practices and financial statements and the independence qualifications and performance of our independent auditors. Our audit committee also has the authority and responsibility to oversee our independent auditors, to recommend for shareholder approval the appointment and, where appropriate, replacement of our independent auditors and to pre-approve audit engagement fees and all permitted non-audit services and fees. We have adopted an audit committee charter, which sets forth the qualifications, powers and responsibilities of our audit committee.

Our audit committee also serves as (i) our compensation committee, authorized to determine the compensation of our executive officers, (ii) our nominations committee, authorized to recommend all director nominees for the selection of the board of directors, provided that no such recommendation is required in cases, if any, where the right to nominate a director legally belongs to a third party, and (iii) our qualified legal compliance committee, responsible for investigating reports, made by attorneys appearing and practicing before the SEC in representing us, of perceived material violations of U.S. federal or state securities laws, breaches of fiduciary duty or similar violations by us or any of our agents.

All the members of our audit committee are "independent directors" under the Nasdaq rules and meet the additional qualifications for membership on an audit committee.

## Internal Auditor

Under the Companies Law, the board of directors must appoint an internal auditor proposed by the audit committee. The role of the internal auditor is to examine, inter alia, whether the company's actions comply with the law and orderly business procedure. The internal auditor must satisfy certain independence standards. Doron Cohen C.P.A., of the accounting firm of Fahn – Kanne & Co. Grant Thornton Israel, serves as our internal auditor.

## Fiduciary Duties of Office Holders

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

information on the advisability of a given action brought for his approval or performed by him by virtue of his position; and

all other important information pertaining to these actions.

The duty of loyalty of an office holder includes a duty to:

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

refrain from any activity that is competitive with the company;

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

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

## Disclosure of Personal Interest of an Office Holder

The Companies Law requires that an office holder of a company disclose to the company any personal interest that he may have and all related material information known to him, in connection with any existing or proposed transaction by the company. The disclosure is required to be made promptly and in any event no later than the board of directors meeting in which the transaction is first discussed. If the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by:

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

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

Under Israeli law, an extraordinary transaction is a transaction:

· other than in the ordinary course of business;

· otherwise than on market terms; or

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

### Approval of Related Party Transactions

Once an office holder complies with the above disclosure requirement, the board of directors may approve a transaction between the company and an office holder, or a third party in which an office holder has a personal interest. A transaction that is adverse to the company's interest may not be approved.