

MIND CTI LTD  
Form 20-F  
June 27, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

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

**OR**

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

For the fiscal year ended December 31, 2006

**OR**

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

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

Commission file number 000-31215

**MIND C.T.I. LTD.**

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

**ISRAEL**

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(Jurisdiction of incorporation or organization)

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

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(Address of principal executive offices)

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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
<b>Ordinary Shares, nominal value NIS 0.01 per share</b>	<b>Nasdaq Global Market</b>

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

None

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(Title of Class)

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

None

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(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, 2006, the Registrant had outstanding **21,547,019** 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 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 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

## Cautionary Statement Regarding Forward-Looking Information

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, 2006. 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, 2005 and 2006 and for each of the three years in the period ended December 31, 2006 and the related notes thereto are included elsewhere in this annual report. You should read the selected financial data in conjunction with Item 5 "Operating and Financial Review and Prospects."

Years ended December 31,

2002	2003	2004	2005	2006
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(In US \$ thousands, except share and per share data)

**Consolidated Statement of Operations Data:**

Revenues:					
Sales of licenses	\$ 6,535	\$ 8,105	\$ 11,699	\$ 7,420	\$ 8,467
Services	3,473	4,831	6,107	8,181	11,593
Total revenues	10,008	12,936	17,806	15,601	20,060
Cost of revenues	2,479	3,208	4,394	4,015	5,675
Gross profit	7,529	9,728	13,412	11,586	14,385
Research and development expenses	3,723	3,319	3,833	5,086	6,118
Selling, general and administrative expenses:					
Selling and marketing expenses	4,154	4,065	4,517	2,148	3,628
General and administrative expenses	1,279	1,115	1,857	1,507	2,135
Operating income (loss)	(1,627)	1,229	3,205	2,845	2,504
Financial income (expenses) - net	2,078	2,573	3,834	1,260	(222)
Income before taxes on income	451	3,802	7,039	4,105	2,282
Taxes on income	117	169	162	43	1,373
Net income	\$ 334	\$ 3,633	\$ 6,877	\$ 4,062	\$ 909
Earnings per ordinary share					
Basic	\$ 0.02	\$ 0.18	\$ 0.33	\$ 0.19	\$ 0.04
Diluted	\$ 0.02	\$ 0.17	\$ 0.32	\$ 0.19	\$ 0.04
Weighted average number of ordinary shares used in computation of earnings per ordinary share - in thousands:					
Basic	20,677	20,732	21,089	21,431	21,515
Diluted	20,761	21,143	21,468	21,619	21,546

As of December 31,

2002	2003	2004	2005	2006
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(In US \$ thousands)

**Consolidated Balance Sheet Data:**

Cash and cash equivalents	\$ 11,312	\$ 4,391	\$ 18,687	\$ 10,174	\$ 27,571
Working capital	11,334	4,006	18,866	9,471	28,926
Total assets	47,967	49,979	55,716	55,652	53,791
Share capital and additional paid-in capital	61,142	58,567	59,130	59,452	59,601
Total shareholders' equity	44,482	45,540	50,244	49,485	47,859

**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**

**We seek to 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 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.

Future acquisitions involve known and unknown risks that could adversely affect our future revenues and operating results. For example:

- we may fail to identify acquisitions that enable us to execute our business strategy;
- we compete with others to acquire companies. We believe that this competition has intensified and may result in decreased availability of, or increased prices for, suitable acquisition candidates;
- we may not be able to obtain the necessary regulatory approvals, including the approval of anti-competition regulatory bodies, in countries where we are seeking to consummate acquisitions;
- we may ultimately fail to consummate an acquisition even if we announce that we plan to acquire a company;
- we may fail to successfully integrate acquisitions in accordance with our business strategy;
- we may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses we acquire and, if we cannot retain such personnel, we may not be able to attract new skilled employees and experienced management to replace them; and
- we may purchase a company that has contingent liabilities that include, among others, known or unknown patent or product.

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.

**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 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 2005 and 2006, approximately 93% and 94% 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 addition, we have a technical and support team in Jassy, Romania. We plan to 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.

**Because some of our customers require a lengthy approval process before they order our products, our sales process is often subject to delays that may decrease our revenues and seriously harm our business.**

In 2006, we derived 86% of our revenues from the sale of software and related services to telecommunications service providers. Before we can sell our software to some of these customers, they conduct a lengthy and complex approval and purchasing process. The following factors, among others, affect the length of the approval process:

- the time required for our customers to determine and announce their specifications;

- the time required for the customer to receive the internal approvals necessary in order for it to commit significant resources towards acquisition of the billing solution;
- the build-up of the customer's network infrastructure; and
- the timely release of new versions of products comprising enhanced functionality, specifically requested by the customer.

Additional delays in product approval may decrease our revenues and could seriously harm our business and results of operations.

**A slow down in expenditures by telecommunications service providers could have a material adverse effect on our results of operations.**

There is a global uncertainty with respect to the direction of the economy and the telecommunications market. Many new and small service providers have failed and existing service providers have been reducing or delaying expenditures on new equipment and applications. A continuation of such delays or a decline in capital expenditures by telecommunications service providers may 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.

**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 Comverse (after the acquisition by Comverse of the Global Software Services division of CSG Systems International) and Convergys Corporation (after the acquisition of Geneva Technology by Convergys) 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. 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. As a result, our competitors may be able to adapt more quickly than us to new or emerging technologies and changes in customer requirements, and may be able to devote greater resources to the promotion and sale of their products. 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 revenues and operating results may vary significantly from quarter to quarter.**

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

- the timing of orders for our software may be delayed as customers typically order 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 for our products by customers;
- the ability of our customers to expand their operations and increase their subscriber base, including their ability to obtain financing;
- changes in our pricing policies or competitive pricing by our competitors; and
- the timing of product introductions by competitors.

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 traditional 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 traditional services.

**From time to time, our software and the systems into which it is installed 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.**

From time to time, our software, as well as the systems into which it is integrated, contain 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.

**Our business may be negatively affected by exchange rate fluctuations.**

Although most of our revenues are denominated in U.S. dollars, approximately 40% of our expenses are incurred in New Israeli Shekels, or NIS. As a result, we may be negatively affected by fluctuations in the exchange rate between the Euro or the NIS and the U.S. dollar. For example, in 2006, the value of the U.S. dollar decreased in relation to the NIS by 8.2%, while inflation decreased by only 0.1%. As a result, our salary expenses, which are primarily linked to the NIS, increased in U.S. dollar terms. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation or appreciation of the NIS against the U.S. dollar. If the U.S. dollar cost of our operations in Israel increases, our U.S. dollar-measured results of operations will be adversely affected. In addition, devaluation in the Euro or local currencies of our customers relative to the U.S. dollar could cause customers to decrease or cancel orders or default on payment. 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. The imposition of price or exchange controls or other restrictions on the conversion of foreign currencies could affect our ability to collect payments, which in turn, could have a material adverse effect on our results of operations and financial condition.

**If our products fail to achieve widespread market acceptance, our results of operations will be harmed.**

Our future growth depends on the continued commercial acceptance and success of our products. We first introduced our billing and customer care software for Voice over IP in 1997 and since then we have developed new versions that offer mediation, rating, billing and customer care for multiple services. Accordingly, we cannot be sure that our products will achieve widespread market acceptance. Our future performance will depend on the successful development, introduction and consumer acceptance of new and enhanced versions of our products. We are not certain that we will be able to develop new and enhanced products to meet changing market needs. If our new and enhanced products are not well received in the marketplace, our business and results of operations will be harmed. We cannot assure you that we will be successful in developing and marketing new products.

**We depend on our marketing alliances and reseller arrangements with manufacturers of telecommunications equipment to market our products. If we are unable to maintain our existing marketing alliances, or enter into new alliances, our revenues and income will decline.**

We have derived, and anticipate that we will continue to derive, a significant portion of our market opportunities and revenues from our marketing alliances and reseller arrangements with major manufacturers of telecommunications equipment, including Alcatel, Cisco, Lucent and Siemens, which market or recommend our products to their customers. Our marketing alliances and reseller arrangements with these parties are nonexclusive and do not contain minimum sales or marketing performance requirements. In some instances, there is no formal contractual arrangement. As a result, these entities may terminate these arrangements without notice, cause or penalty. There is also no guarantee that any of these parties will continue to market our products. Our arrangements with our resellers and marketing allies do not prevent them from selling products of other companies, including products that compete with ours. Moreover, our marketing allies and resellers may develop their own internal mediation, rating, billing and customer care software products that compete with ours and sell them as part of their equipment. If we are unable to maintain our current marketing alliances and reseller relationships, or if these marketing allies and resellers develop their own competing mediation, rating, billing and customer care software products, our revenues and income will decline.

**If our software does not continue to integrate and operate successfully with the telecommunications equipment of the leading manufacturers, we may be unable to maintain our existing customer base and/or generate new sales.**

The success of our software depends upon the continued successful integration and operation of our software with the telecommunications equipment of the leading manufacturers. We currently target a customer base that uses a wide variety of network infrastructure equipment and software platforms, which are constantly changing. In order to succeed, we must continually modify our software as new telecommunications equipment is introduced. If our product line fails to satisfy these demanding and rapidly changing technological challenges, our existing customers will be dissatisfied. As a result, we may be unable to generate future sales and our business will be materially adversely affected.

**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 Eisinger, 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 Ms. Eisinger or other members of the senior management team are unable or unwilling to continue their employment with our company, 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 our billing and customer care software for IP services fails to achieve market acceptance among traditional telecommunications service providers, we may suffer a decrease in market share, revenues and profitability.**

We believe that as the demand for IP services grows, traditional telecommunications service providers will increasingly offer IP services to remain competitive and these providers will constitute a growing portion of the IP services market. These companies already have relationships with traditional billing and customer care software providers for their telephony services, and may wish to work with their current providers of billing and customer care software to enhance and modify that software for IP services. If our billing and customer care software for IP services fails to achieve market acceptance among traditional telecommunications service providers, we may suffer a decrease in market share, revenues and profitability.

**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 have not yet completed our evaluation of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act.**

We are considered a "non-accelerated filer" under applicable SEC rules. As such, we are required to comply with internal control evaluation and certification requirements of Section 404 of the Sarbanes-Oxley Act of 2002 in the following manner: (1) reporting by management under Section 404(a) of the Sarbanes-Oxley Act will be required for the fiscal year ending on December 31, 2007, and (2) attestation by our independent auditors under Section 404(b) of the Sarbanes-Oxley Act will be required for the fiscal year ending December 31, 2008. Accordingly, we have begun to evaluate whether our existing internal control over financial reporting system is compliant with Section 404. As a result of this evaluation, we may be required to implement new internal control procedures over financial reporting. We may also experience higher than anticipated operating expenses and fees in this context, additional commitment of management's time and may need to hire additional qualified personnel in order to achieve compliance with Section 404. If we are unable to implement these changes effectively or efficiently, or if our internal controls are found to be ineffective in future periods, it could harm our operations, financial reporting or financial results and could result in our being unable to obtain an unqualified report in internal controls from our independent auditor.

**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 business internationally. 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 June 1, 2007, we had 21,592,510 outstanding ordinary shares, of which approximately 17 million ordinary shares were freely tradable without restriction or further registration under the federal securities laws unless purchased by our "affiliates", as that term is defined in Rule 144 under the Securities Act. As of June 1, 2007, there were outstanding options to purchase a total of 1,114,010 ordinary shares, of which 447,010 were vested. We were also authorized to grant options to purchase 2,215,700 additional ordinary shares. We have filed a registration statement on Form S-8 covering all of the ordinary shares issuable upon the exercise of options under our 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.

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

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

### **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. The establishment in early 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group has created additional unrest and uncertainty in the region. Further, in the summer of 2006, Israel fought a war against Hezbollah, a Lebanon-based Islamist Shiite militia group, which involved thousands of missile strikes and disrupted most day-to-day civilian activity in northern Israel. 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 restrict business with Israel and Israeli companies, and additional countries may restrict doing business with Israel and Israeli companies as a result of the recent increase in hostilities. 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 9 to our financial statements contained in Item 18.

**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.

**Our operating results may be negatively affected by the obligation of some of our key personnel to perform military service.**

Some of our executive officers and employees in Israel are obligated to perform military reserve duty, which could accumulate annually from several days to up to two months in special cases and circumstances. The length of such reserve duty depends, among other factors, on an individual's age and prior position in the army. In addition, if a military conflict or war occurs, these persons could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees due to military service. Any disruption in our operations would harm our business.

**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 Sentori, Inc. and its principal offices are located at 12211 Plum Orchard Drive, Suite 320, Silver Spring, MD 20904, USA.

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

In 1997 we started the development and marketing of a real-time mediation and billing solution, mainly to the Internet protocol, or IP, prepaid markets, known as MIND-iPhonEX.

During 2005, we completed the acquisition of the Sentori Inc., a U.S. leading provider of customer care and billing solutions to wireless carriers and mobile virtual network operators, or MVNOs, mainly in the United States and the Caribbean. We are in the process of incorporating the Sentori functionality into the MIND-iPhonEX product line, and we intend to brand the combined products under the MINDBill name. We plan to continue to support the Sentori product with new maintenance releases, as well as customization requests. In addition, we will offer our existing customers a migration path to MINDBill.

During 2005 and 2006 we invested heavily in the development of MINDBill and started the implementation of MINDBill at a large East European operator with over one million subscribers. We believe that this valued reference customer will serve us to gain more large sized deals in mobile markets.

### **Principal Capital Expenditures**

During 2004, 2005 and 2006, the aggregate cash amounts of our capital expenditures were \$1.2 million, \$0.6 million and \$0.4 million, respectively. 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.

## **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, 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 post-paid 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. Post-paid subscribers, including credit-limited and non-limited, either retail or business customers, represent the loyal and the higher average revenue per user, or ARPU, market. All services used by a post-paid 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 and traditional telecommunication equipment.

The latest version of 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, that are 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 three call management systems used by organizations for call accounting, traffic analysis and fraud detection. Our traditional enterprise software, which we call PhonEX, has been installed in over 15,000 locations throughout the world. Our other enterprise software, which we call MEIPS, is a product directed towards the same market segment where IP switches are implemented. MEIPS has been installed in over 1,000 locations around the world. Our latest product, PhonEXONE, delivers one unified solution for all voice communication expenses including traditional, IP and mobile telephony. The flexible and scalable architecture of PhonEXONE 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 more rapidly, 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.

Recently, many telecommunications service providers have initiated searches for billing solutions to replace existing ones, mainly in the developed telecom markets, where competition, consolidation and customer loyalty are key issues. Service providers explore the option to replace existing solutions in order to offer additional services, reduce costs and improve service.

An additional market opportunity is the trend towards all-IP networks, offering multiple next generation services, particularly in the developing world. New investment is taking place in many of these regions, driven by social and economic factors, with new licenses and new initiatives, such as VoIP and downloaded content. 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 Sentori acquisition, with its existing mobile customer base, provided the required presence to build upon and enhance our position in the mobile market. With our combined product - MINDBill - we will be able to offer convergent services billing to the already existing customer base and to new GSM and CDMA operators.



A niche market in the mobile market in which we see opportunities in is the MVNO market. Market saturation is pushing mobile carriers that own the network, to use MVNOs as an alternative means for subscriber growth, without incurring the associated costs of acquiring and servicing a subscriber as the additional subscribers are acquired and serviced by the MVNO. Along with cutting operational costs, it enables the operators to increase their network utilization and revenues through wholesale agreements with the MVNOs. Typically, to create competitive differentiation, MVNOs require a billing and customer care solution that can ensure short time-to-market and product bundling. MVNOs specifically target consumers in well defined niches such as ethnic communities, young people and those with poor credit. Niche markets previously considered undesirable by wireless carriers due to exotic usage profiles - are now attracting attention. We have a number of MVNO's as customers and we are focused on delivering solutions that address this particular market.

### *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.

For service providers, Voice over IP presents an opportunity to generate revenue by offering additional services over the new broadband networks deployed. Voice over IP networks enable the deployment of most of the services customer receive over traditional networks at a much lower capital cost of infrastructure and reduced management cost of the network. As Voice over IP is distance independent, it allows service providers to offer competitive pricing, as only a small portion of the traffic, if any, terminates on traditional networks.

As service providers deploy convergent IP networks that can offer voice, data, video and content services, the demand for more sophisticated billing software is expected to grow. We believe that as providers of convergent networks continue to expand their service offerings, they will increasingly need products that allow them to monitor and bill their subscribers based on the type and content of services provided. As a result, we believe that this trend will increase the demand for sophisticated billing and customer care products for what is known as convergent billing, such as the solutions we offer.

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 potential number of users have been, and future increases will be, accomplished without the need to modify or replace our installed software;
- *Interoperability.* Currently, there are many standards for the interface between telecommunications equipment and billing products, such as Radius, SIP, and Diameter. Our billing platform is fully compliant with those interfaces and is interoperable with the telecommunications equipment of most of the leading manufacturers, including Alcatel, Cisco, Ericsson, Lucent, Nokia, Nortel and Siemens. This interoperability provides us with a competitive advantage, as it enables our customers to use networks composed of equipment manufactured by multiple vendors. It also allows providers to upgrade an existing network with new and different equipment without changing their billing and customer care products; and
- *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.

We believe that the strategic acquisition of Sentori in August 2005 strengthened our presence in the United States and in the mobile market. We have since successfully completed the integration process.

In 2006 we went through a transition phase. We invested heavily in the enhancement of our solutions, while focusing on building our business for the long-term, with larger deals and long-term contracts. These require longer sales-cycles and longer revenue spreads. The long-term relationships with our customers enable us to build future revenue streams and significant recurrent revenue from our customer base, from upgrades of licenses and services.

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. In the last three years we significantly increased our 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 30-40% of revenues and gross margins will be approximately 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:

- *Expand offering through acquisitions.* We evaluate acquisition opportunities pro-actively, based on our long-term policy of growing the scale of our business and enhancing our offering, through acquisitions, which will enhance shareholder value. Our active pursuit is for business lines that provide the majority of the following criteria: existing customer base, channels and partners, presence in complementary geographic areas or markets and proven complementary technology. We will pursue such an opportunity if we estimate that it will provide an additional step towards tier 2 market leadership and that the acquisition will be accretive to our income within two or three quarters;
- *Leverage our brand name recognition and technical expertise.* We were one of the first to provide billing and customer care software for IP telephony, introducing MIND-iPhonEX 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 significant brand name recognition among Voice over IP providers. The acquired Sentori customer base, team and technology has provided us with significant brand name recognition in the mobile market. We intend to leverage our reputation, brand name and recognition in the wireline and wireless markets;
- *Enhance alliances with industry leaders.* We have established cooperative relationships with leading manufacturers of telecommunications and hardware equipment and system integrators. We team with these industry leaders in marketing activities, as well as in the research and development and implementation stages of product development and enhancement. Our alliances allow us to broaden our marketing capabilities significantly, support new features offered by equipment vendors as these features are introduced to the market, and maintain our technology leadership over our competitors. We intend to continue to leverage these alliances in order to solidify and expand our market presence.
- *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 products for voice, data, video and content services that meet the mission-critical needs of convergent IP, Wireline and Wireless service providers and is interoperable with the telecommunications equipment of major manufacturers

Our highly functional and adaptable product enables our customers to quickly deploy new services and to rapidly grow and add new services. Our solutions support both prepaid billing plans, in which customers pre-pay 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 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 dial into 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 time, if any, of the call or data session;
- *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 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.
- *Call Shops.* In order to place a long-distance/international call, a person may come to a special calling center, also known as a call shop. The call shop policy may require that the person make a deposit before calling, the remaining amount being returned after the invoice is generated. MIND's billing solution supports the special business model for call shops, including fast and reliable Web access and customized reports for profit and

loss;

- *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;
- *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.
- *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;
- *Cashier Module.* Our Cashier module offers the ability to perform cash registration, posting of payments and refunds and direct sales of services and equipment. The module provides cash register management, credit card processing and analysis reporting capabilities;
- *Resource Management Module.* Our Resource Management module 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 solutions for the flow management from the reception of the items up to the allocation of the items to the customers;
- *Business Processes.* MIND is offering in its deployments tailored, fully automated, order management processes, trouble tickets, and debt collection processes, all unique to its market segment. 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, technician test, etc.), integration with external legacy systems (such as inventory), interaction with third party services (such as address validation) and more. MIND's billing solution uses its robust 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, pager, audio or visual alarms;
- *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 excel with today's top challenges. 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.

### *Enterprise Software*

Our enterprise products, known as PhonEX, MEIPS and PhonEXONE, are used by corporations for call accounting, traffic analysis and fraud detection. PhonEX is a call management system that collects, records and stores all call information in a customized database. The system:

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

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

Manufacturers of IP telecommunications equipment have begun to develop and market Voice over IP systems for enterprises. Our enterprise solution for IP switches, known as MEIPS, is used to provide call accounting, traffic analysis and fraud detection for enterprises that use IP telephony. MEIPS provides substantially the same functionality as PhonEX.

Our high end product, PhonEXONE, delivers one unified solution for all voice communication expenses, including traditional, IP and mobile telephony. The flexible and scalable architecture of PhonEXONE meets the needs of large enterprises, supporting an unlimited number of extensions and sites. Some of its major advantages are:

- web-based solution, providing full functionality through a web browser;
- scalable system architecture, supporting an unlimited number of sites and extensions;
- multilingual and multicurrency: the perfect solution for multinational organizations;
- supports IP, traditional and hybrid telephony networks; and
- Supports the Microsoft SQL database and is enhanced by the advanced ASP.NET technology.

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, that are 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 code. 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 services 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 and also 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*

In Europe, the United States and Israel our enterprise software is sold by our appointed distributors, resellers and directly through our sales force.

### *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 market.

Years ended December 31,  
(in thousands of US \$)

	2004	2005	2006
The Americas (total)	1,977	5,556	9,643



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Sale of Licenses	1,020	2,870	4,854
Services	957	2,686	4,789
Asia Pacific and Africa (total)	2,859	2,702	1,619
Sale of Licenses	1,957	1,724	575
Services	902	978	1,044
Europe (total)	12,017	6,285	7,693
Sale of Licenses	8,361	2,503	2,769
Services	3,656	3,782	4,924
Israel (total)	953	1,058	1,105
Sale of Licenses	361	323	269
Services	592	735	836
Total	17,806	15,601	20,060
Sale of Licenses	11,699	7,420	8,467
Services	6,107	8,181	11,593

### **Customers**

#### *Billing and Customer Care Solutions*

We currently provide traditional telecommunications service providers, Internet telephony service providers and Internet service providers with our billing and customer care software. MIND-iPhonEX, VeraBill and the Sentori product line 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), Sri Lanka Telecom, Telecom Colombia, and VTI;
- traditional wireline telephony providers, such as Teledome and Telefonía Bonairiano;
- wireless telephony providers, such as Bahamas Telecom, CelTel Tanzania and mTel Nigeria;
- 3rd generation (3G) mobile operators that provide broadband mobile IP services, such as H3G Italy; and
- MVNOs, such as Viaero.

#### *Enterprise Software*

Our enterprise software has been installed at over 15,000 locations throughout 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 Comverse (after the acquisition by Comverse of the Global Software Services division of CSG Systems International) and Convergys Corporation (after the acquisition of Geneva Technology by Convergys).

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, mediation, provisioning, rating for multiple services and prepaid IP functionality;
- our proven platform that is eight years operational and our 10 years of wireless and IP experience to satisfy customer requirements;
- our flexibility to meet customer requirements in a short time frame; and
- our financial strength.

However, we depend on our marketing alliances with manufacturers of telecommunications equipment and reseller arrangements to market our billing and customer care software. Some of our marketing allies and resellers also work with some of our competitors. Our marketing alliances and reseller arrangements are for the most part non-exclusive and do not contain minimum sales or marketing performance requirements. We may not be able to compete effectively with our competitors under these circumstances. Many of our competitors have greater financial, personnel and other resources, have longer and more established relationships with service providers and may be able to offer more aggressive pricing or devote greater resources to the promotion of their products. In addition, one or more of our competitors could develop superior products and these products could achieve greater market acceptance than our product.

#### *Enterprise Software*

Our main competitors in the market for enterprise software products include Avotus Corporation and Veramark Technologies, Inc. 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.

#### **Israeli Office of the Chief Scientist**

Under the Israeli Law for the Encouragement of Industrial Research and Development, 1984, or the Research and Development Law, research and development programs which meet specified criteria and are approved by the Office of the Chief Scientist are eligible for grants of up to 50% of certain approved expenditures, in exchange for the payment of royalties from the sale of products (and any ancillary services) incorporating or based upon know-how developed in accordance with such programs, until the repayment in full of the dollar linked amount of the grants received. We have received grants in the past from the Office of the Chief Scientist and have repaid them.

Even after repayment in full of royalty obligations, the Research and Development Law and prohibits the transfer of the funded know-how outside of Israel without the prior approval of the Office of the Chief Scientist. Further, the Research and Development Law requires that the manufacture of products incorporating or basing upon funded know-how be performed in Israel.

The Research and Development Law contains reporting requirements with respect to certain changes in the ownership of a grant recipient. The Research and Development Law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the provisions of the Research and Development Law. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A

person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights and the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires directly 5% or more of our ordinary shares will be required to notify the Office of the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research and Development Law.

### **C. Organizational Structure**

Set forth below is a list of our significant subsidiaries:

- Sentori Inc., a wholly owned subsidiary, incorporated in the State of Delaware;
- MIND C.T.I. Inc., a wholly owned subsidiary, incorporated in the State of New Jersey;
- 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 16,000 square feet at our Yoqneam headquarters. We also lease 10,593 square feet of office space in Silver Spring, Maryland and 21,500 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. We are currently considering purchasing or constructing a building for our office in Romania.

### **Item 4A. Unresolved Staff Comments**

Not applicable.

### **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, including the related notes, contained in Item 18.

#### **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 2006, 85.6% of our revenues were derived from providing our billing and customer care software and 14.4% were derived from providing our enterprise software. In 2006, license fees represented 42.2% of our revenues and professional services represented 57.8%. In 2005 and 2006, no customer accounted for 10% or more of our total revenues. However, we expect to continue to derive sizeable revenues from a small number of changing customers.

In 2001, we acquired the VeraBill product line for billing and customer care for traditional tier 3 wireline and wireless service providers. 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 MVNOs, mainly in the United States and the Caribbean. We evaluate acquisition opportunities pro-actively, based on our long-term policy of growing the scale of our business and enhancing our offering through acquisitions that are expected to enhance shareholder value.

In 2003 and 2004, we experienced quarterly sequential revenue growth and improved profitability and net income. Our revenue growth in 2004 was driven primarily by our winning larger projects than in the past, especially in Europe. In the first quarter of 2005, our revenue fell sharply to \$3.08 million from \$4.88 million in the previous quarter, due to loss of revenues caused by the cancellation of two large orders that we received in 2004 for reasons unrelated to us and in addition, the customer that represented 36% of our revenues in 2004, entered into a reorganization process and, as a result, the planned enhancements of our platform did not materialize. These three customers were expected to represent over 30% of our annual revenue. Consequently, our total 2005 revenue was lower than our 2004 revenue. In spite of the unexpected loss of revenue in first quarter of 2005, we succeeded in maintaining profitability and in showing sequential revenue growth for the four quarters thereafter. In 2006 we experienced significant growth in revenue driven primarily by our acquisition of Sentori in the third quarter of 2005, which strengthened our presence in the United States and in the mobile market generally.

As we increase our focus on end-to-end billing solutions for tier 2 and tier 3 service providers and our average deal size increases, our long-term business model changes as the professional services part of our business is increasing. An additional consequence is that projects are often now of a more complex 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. In the last three years we significantly increased our professional services team to support the growth in services offered to customers.

Since March 2002, we have deposited most of our cash in structured, callable time deposits. Under the arrangements with the banks, whether or not the deposits bear interest depends upon the prevailing U.S. dollar LIBOR rate. Interest is payable in respect of days during which the rate is within a certain range and no interest is payable in respect of days during which it exceeds the range. Until May 2005, we achieved relatively high interest rates of over 7% per annum. Since May 2005, due to the increase of the six-month LIBOR rate, the deposits did not bear interest, causing our financial income to decrease substantially starting in the third quarter of 2005. In the second quarter of 2006, we withdrew two of our three structured deposits in the aggregate amount of \$20 million. The financial expenses arising from the early redemption of these two deposits were \$1.33 million. In the fourth quarter of 2006 the third and last structured deposit in the amount of \$10 million was released with no penalty. Since December 2006, all our funds are invested in risk-free bank deposits and investment grade, interest-bearing bonds or debentures. See below under Item 5.B - "Liquidity and Capital Resources" 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. Additionally the board approved dividend distributions in 2003 and 2007 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. Since 2003 the Company distributed cash dividends of approximately \$0.85 per share to its 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 and \$0.20 per share in 2007. 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.

*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, 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.

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 scale of the network supported by our software. 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 limited by the traffic metrics chosen by the customer, maintenance and services fees, and additional fees to expand the scale of the network supported by our software.

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 Oracle, hardware, amortization of intangible assets, packaging and shipping costs. Our cost of professional services revenues consists primarily of direct labor costs and travel expenses. Our revenues from the sale of our licenses have a higher gross margin than that from providing our professional services. We incur variable direct labor costs when we provide professional services. There is no comparable variable direct labor cost incurred when we license our software.

*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 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, accounting, professional fees, insurance, provisions for doubtful accounts and other general corporate expenses.

*Financial Income (Expenses), net.* Our financial income (expenses), net consists primarily of interest earned on bank deposits, gains and losses from the conversion of monetary balance sheet items denominated in non-dollar currencies into U.S. dollars, net of financing costs, loss from withdrawal of long-term bank deposits and bank charges in real terms as well as the devaluation of monetary assets and monetary liabilities.

*Taxes on Income.* Israeli companies are generally subject to income tax at the corporate tax rate of 34% for the 2005 tax year, 31% for the 2006 tax year and 29% for the 2007 tax year. Following an amendment to the Israeli Income Tax Ordinance that came into effect on January 1, 2006, the corporate tax rate is expected to decrease as follows: 27% for the 2008 tax year, 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter. However, Israeli Companies are generally subject to capital gains tax at a rate of 25% for capital gains, other than gains deriving from the sale of listed securities, derived after January 1, 2003. Substantially all of our facilities, however, have been granted "approved enterprise" status under the Law for the Encouragement of Capital Investments, 1959. Income derived from the approved enterprise is tax exempt for a period of ten years commencing in the first year in which we earn taxable income from the approved enterprise, since we have elected the "alternative benefits route" (involving a

waiver of investment grants) and our approved enterprises are located in a preferred geographic location. In the event of distribution of cash dividends from income that was tax exempt, we would have to pay up to 25% tax in respect of the amount distributed. In February 2007, we finalized tax assessments for the tax years 2003 to 2005, which resulted in additional tax expenses in 2006 of approximately \$1.5 million.

## A. Operating Results

The following discussion of our results of operations for 2004, 2005 and 2006, 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, included in this annual report:

	Years ended December 31,		
	2004	2005	2006
Revenues:	100.0%	100.0%	100.0%
Cost of revenues	24.7	25.7	28.3
Gross profit	75.3	74.3	71.7
Research and development expenses	21.5	32.6	30.5
Selling, general and administrative expenses:			
Selling and marketing expenses	25.4	13.8	18.1
General and administrative expenses	10.4	9.7	10.6
Operating Income	18.0	18.2	12.5
Financial income (expenses) - net	21.5	8.1	(1.1)
Income before taxes on income	39.5	26.3	11.4
Taxes on income	0.9	0.3	6.8
Net income	38.6	26.0	4.6

### Comparison of 2004, 2005 and 2006

#### Revenues

	Years ended December 31,			% Change 2005 vs. 2004	% Change 2006 vs. 2005
	(\$ in millions)				
	2004	2005	2006		
License sales	11.7	7.4	8.5	(36.6)	14.1
Professional services	6.1	8.2	11.6	34.0	41.7
Total revenues	17.8	15.6	20.1	(12.4)	28.6

Revenues in 2005 decreased in comparison to 2004 due to the unexpected cancellation of large orders from two customers and due to the cancellation of the planned orders from our largest customer (that represented 36% of our revenues in 2004) in the first quarter of 2005. Our revenues in 2006 in comparison to 2005 increased by 28.6% mainly because of the acquisition of Sentori, which strengthened our presence in the United States and in the mobile market generally. Revenues from our billing and customer care product solutions for service providers decreased from \$15.2 million in 2004 to \$12.7 million in 2005 and increased to \$17.2 million in 2006. Revenues from our enterprise products increased from \$2.6 million in 2004 to \$2.9 million in 2005 and remained almost unchanged from 2005 to 2006. The increase from 2004 to 2005 was driven primarily by our winning larger projects.

Revenues from professional services as a percentage of total revenues increased from 34% in 2004 to 52% in 2005 due to the lower 2005 revenue and further increased to 58% in 2006 as a result of the growth in our customer base that provides more maintenance revenues and as a result of our focus on larger deals, which are often of a more complex nature and require more professional services.

The following table presents the geographic distribution of our revenues:

	Years ended December 31,			
	2004	2005	2006	
The Americas	11.1%	35.6%	48.1%	
Asia Pacific and Africa	16.1	17.3	8.1	
Europe	67.5	40.3	38.3	
Israel	5.3	6.8	5.5	
Total	100.0%	100.0%	100.0%	

Our sales in the Americas steadily increased between 2004 and 2006 as the result of our acquisition of Sentori in the third quarter of 2005 which strengthened our presence in the United States and in the mobile market generally. Our sales in Europe decreased in 2005 due to the fact that a customer which represented 36% of our revenues in 2004 entered into a reorganization process and, as a result, the planned enhancement of our platform did not materialize.

#### Cost of Revenues

	Years ended December 31, (\$ in millions)			% Change	% Change
	2004	2005	2006	2005 vs. 2004	2006 vs. 2005
Total cost of revenues	4.4	4.0	5.7	(8.6)	41.3

The decrease in 2005 in our cost of revenues was mainly due to the decrease in revenues, which in turn caused a decrease in the cost of revenue related to third parties, offset by an increase in the cost of employment. The increase in our cost of revenues in 2006 was primarily due to the increase in our revenues from professional services (as explained above) and due to the continued increase in employee payroll costs, driven by an increase in the cost of employment per employee as well as an increase in the total number of employees engaged in support and maintenance.

Gross profit as a percentage of revenues decreased from 75.3% in 2004 to 74.3% in 2005 and to 71.7% in 2006, due to the increase in our revenues from professional services as a percentage of total revenues as well as the increase in employee payroll costs, driven by the continued increase in the cost of employment per employee as well as an increase in the total number of employees engaged in support and maintenance.

#### Operating Expenses

	Years ended December 31, (\$ in millions)			% Change	% Change
	2004	2005	2006	2005 vs. 2004	2006 vs. 2005
Research and development	3.8	5.1	6.1	32.7	20.3
Selling and marketing	4.5	2.1	3.6	(52.4)	68.9
General and administrative	1.9	1.5	2.1	(18.8)	41.7

*Research and Development.* We make substantial investment in research and development to maintain our advanced technology and add functionality to our products. The increase in 2005 and 2006 in our research and development expenses was primarily due to an increase in the cost attributable to payroll and related expenses of our employees engaged in research and development resulting from an increase in the salary per employee and an increase in the total number of employees engaged in research and development. Research and development expenses as a percentage of revenues increased from 21.5% in 2004 to 32.6% in 2005 and slightly decreased to 30.5% in 2006. The increase between 2004 and 2005 was due to an increase of research and development expenses accompanied by a decrease in revenues. The decrease between 2005 and 2006 was due to an increase in revenues in excess of the increase in research and development expenses.

*Selling and Marketing Expenses.* Selling and marketing expenses substantially decreased from \$4.5 million in 2004 to \$2.1 million in 2005, primarily reflecting a decrease in commission expenses (normally incurred as a percentage of revenue), as a result of the decrease in revenues in 2005. In 2006 selling and marketing expenses increased to \$3.6 million mainly due to a significant increase of our sales teams (especially in the United States as a result of the acquisition of Sentori), and due to an increase in commission expenses as the result of the increase in revenues. Selling and marketing expenses as a percentage of revenues decreased from 25.4% in 2004 to 13.8% in 2005 due to a decrease in expenses in excess of the decrease in revenues. Selling and marketing expenses as percentage of revenues increased to 18.1% in 2006 due to an increase in selling and marketing expenses in excess of the increase of revenues.

*General and Administrative Expenses.* General and administrative expenses decreased from \$1.9 million in 2004 to \$1.5 million in 2005 and increased to \$2.1 million in 2006. The decrease between 2004 and 2005 was mainly because of a decrease in the allowance for doubtful accounts. The increase between 2005 and 2006 was mainly due to additional professional services, mainly legal.

*Financial Income (Expenses).* Financial income decreased from \$3.8 million in 2004 to \$1.3 million in 2005. This decrease resulted from the increase in the rate of the six-month LIBOR, which resulted in our three long-term bank deposits ceasing to bear interest starting in May 2005. We did not receive any interest on deposits in the aggregate amount of \$30 million until June 2006, and we did not receive any interest on a deposit in the amount of \$10 million from June thru December 2006. Financial income further decreased from \$1.3 million in 2005 to financial expenses of \$0.2 million in 2006. This decrease resulted mainly from a one-time penalty in the amount of approximately \$1.3 million for premature withdrawal of two of our three deposits. See also below Item 5.B Liquidity and Capital Resources - Cash Deposits.

#### *Corporate Tax Rate*

The general corporate tax rate in Israel is 34% for the 2005 tax year, 31% for the 2006 tax year and 29% for the 2007 tax year. Following an amendment to the Israeli Income Tax Ordinance that came into effect on January 1, 2006, the corporate tax rate is expected to decrease as follows: 27% for the 2008 tax year, 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter. However, Israeli companies are generally subject to capital gains tax at a rate of 25% for capital gains, other than gains deriving from the sale of listed securities, derived after January 1, 2003. Our effective tax rate, however, was 1% in 2004, 1% in 2005 and 3% in 2006 (before taking in consideration the one-time tax expenses in 2006 resulting from the finalization of the tax assessment for tax years 2003 to 2005). We experienced the lower effective tax rates in 2004 and 2005 primarily because of tax reductions to which we are entitled under Israel's Law for Encouragement of Capital Investments, 1959. In February 2007 we finalized tax assessments for the tax years 2003 to 2005 which resulted in an additional tax expense in 2006 of approximately \$1.5 million. We cannot assure you that the low effective tax rates in 2004, 2005 and 2006 will be available for us in the future. For more information about the taxes to which we are subject, see above under the caption "Overview - Taxes on Income" and below under Item 10.E "Taxation."

#### *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 contained in Item 18. 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, 2006, and we believe that the consolidated financial statements contained in Item 18 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 included in this annual report.

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 Cautionary Statement Regarding Forward-Looking Information 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 Position 97-2 of the American Institute of Certified Public Accounts ("SOP 97-2"), "Software Revenue Recognition" and Statement of Position 81-1 ("SOP 81-1") "Accounting for performance of construction type and certain production type contracts", 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. Customization of the product, if any, is performed before delivery occurs. 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, distributors and resellers. In the event the right of return is granted, revenue is recognized after such right has expired.

*ii) Services:* The services we provide consist of implementation, training, hardware installation, maintenance, support, managed services 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.

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 on number of subscribers and the agreements include a minimum monthly charge. These revenues are recognized on a monthly basis.

Products are mainly supplied with maintenance and support services 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 and

support service 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 solely maintenance and support services.

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 SOP 81-1. We generally determine the percentage-of-completion by comparing the costs incurred to date to the estimated total costs 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.

*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.

*Taxes on Income.*

Substantially all of our production facilities in Israel have been granted Approved Enterprise status under the Law for the Encouragement of Capital Investments, 1959. Income we have derived from the Approved Enterprise is tax exempt. In the event of distribution of cash dividends from tax-exempt income, we are required to pay up to 25% tax in respect of the amount distributed. For more information about Approved Enterprises, see Item 10.E "Taxation - Law for the Encouragement of Capital Investments, 1959" and Note 9 to our financial statements contained in Item 18.

In previous years, we did not provide for deferred taxes because we intended to reinvest the amounts of all such income and not to distribute dividends from such income. Commencing 2003, we changed our policy with regard to distribution of dividends out of earnings derived from tax-exempt income.

Due to the accumulated tax losses, no additional tax liability will be incurred by the Company as a result of dividend distribution from the balance of undistributed income.

*Recently Issued Accounting Pronouncements.*

Recently issued accounting pronouncements are described in note 1 paragraph t to the consolidated financial statements contained in Item 18.

*Our Functional Currency*

The currency of the primary economic environment in which we operate is the U.S. dollar. In 2006, approximately 94% of our revenues were derived from sales outside Israel, which were denominated primarily 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, changes in inventories or similar items), historical exchange rates.

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

#### *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:

<u>Years ended December 31,</u>	<u>Israeli Inflation Rate</u>	<u>Israeli Devaluation Rate</u>	<u>Israel Inflation Adjusted for Devaluation</u>
2002	6.5	7.3	(0.8)
2003	(1.9)	(7.6)	5.7
2004	1.2	(1.6)	2.8
2005	2.4	6.8	(4.4)
2006	(0.1)	(8.2)	(8.1)

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, 2006, we had approximately \$37.6 million in cash, cash equivalents and long-term marketable debentures, and our working capital was \$28.9 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 2004 was \$7.7 million, attributable to our net income of \$6.9 million and non-cash related items, net, in the amount of \$0.9 million,

offset by a net decrease in operating assets and liabilities items in the amount of \$0.1 million. Net cash provided by operating activities in 2005 was \$0.9 million, attributable to our net income of \$4.1 million and non-cash related items, net, in the amount of \$0.8 million, offset by a net decrease in operating assets and liabilities items in the amount of \$4.0 million. Net cash provided by operating activities in 2006 was \$0.6 million, attributable to our net income of \$0.9 million and non-cash related items, net, in the amount of \$1.6 million, offset by a net decrease in operating assets and liabilities items in the amount of \$1.9 million.

*Cash Deposits.* Since March 2002, we have deposited most of our cash in structured, callable time deposits. Under the arrangements with the banks, whether or not the deposits bear interest depends upon the prevailing U.S. dollar LIBOR rate. Interest is payable in respect of days during which the rate is within a certain range and no interest is payable in respect of days during which it exceeds the range. Until May 2005, we achieved relatively high interest rates of over 7% per annum. Starting in May 2005, due to the increase of the six-month LIBOR rate, the deposits did not bear interest, causing our financial income to decrease substantially starting in the third quarter of 2005. In the second quarter of 2006, we withdrew two of our three structured deposits accounts in the amount of \$20 million. The financial expenses arising from the early redemption of these two deposits were \$1.33 million. In the fourth quarter of 2006, the third and last structured deposit in the amount of \$10 million was released with no penalty.

In December 2006 we purchased marketable debentures in the amount of \$10 million for 54 months. The debentures mature in one settlement in 2011 and the issuer has a call option in December 2007. The debentures bear interest at an annual rate of 5.4% and are presented in our balance sheet among the investment and other non-current assets.

In accordance with our existing cash management policy, all our funds are currently invested in risk-free bank deposits and interest-bearing, investment grade bonds or debentures.

*Net Cash Provided by/Used in Investing Activities.* During 2004, 2005 and 2006, our principal investment activity was long-term bank deposits and marketable debentures. In 2005 we also used \$4.2 million for the acquisition of Sentori, Inc.

*Net Cash Provided by/Used in Financing Activities.* In 2004, our financing activities used \$2.2 million due to a cash dividend of \$2.7 million, offset by \$0.5 million in proceeds from the exercise of employee stock options. In 2005, our financing activities used \$4.8 million due to a cash dividend of \$5.1 million, offset by \$0.3 million in proceeds from the exercise of employee stock options. In 2006, our financing activities used \$2.9 million due to cash dividend of \$3.0 million, offset by \$0.1 million in proceeds from the exercise of employee stock options.

*Capital Expenditures.* During 2004, 2005 and 2006, the aggregate cash amounts of our capital expenditures were \$1.2 million, \$0.6 million and \$0.4 million, respectively. 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 the Company distributed cash dividends of approximately \$0.85 per share to its 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 and \$0.20 per share in 2007. For information about our dividend policy, please see Item 8 - "Financial Information-Dividend Policy."

### **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, 2006, our research and development department consisted of 182 employees out of a total of 317 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 most active market lately is the Next Generation Network ("NGN") market. Many service providers are moving towards networks where IP-based equipment will carry a large proportion, and in some cases all, of their traffic. These 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 NGN's.

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 Avaya, Cisco Systems and 3Com 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.

#### 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	\$ 1,556,000	\$ 613,000	\$ 943,000	0	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	\$ 1,556,000	\$ 613,000	\$ 943,000	0	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 Eisinger	49	President, Chairperson of the Board of Directors and Chief Executive Officer
Oren Bryan	32	Chief Financial Officer
Doron Segal	42	Chief Technology Officer
Sagee Aran	43	Vice President - Sales for Asia Pacific and Africa
Danny Engle	38	Vice President - Sales for North America
Tal Shain	39	Vice President - Professional Services
Rimon Ben-Shaoul	62	Director
Menahem Shalgi	57	Director
Zamir Bar-Zion	50	Director

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

*Monica Eisinger.* Ms. Eisinger founded our company and has been President, Chairperson and Chief Executive Officer of our company since inception. Prior to founding MIND, Ms. Eisinger served as an information systems consultant to Raphael, the Israeli Armaments Industry and directed over 40 projects. Ms. Eisinger holds a B.Sc. degree in Computer Science and a M.Sc. degree in Telecommunications (with expertise in Voice and Data Integration over the Ethernet) from the Technion, Israel Institute of Technology.

*Oren Bryan.* Mr. Bryan has served as our Chief Financial Officer since July 2006. Mr. Bryan joined MIND in November 2005 as Controller. Since January 2002 until joining MIND, Mr. Bryan worked for Dor Chemicals Ltd., a multinational public company. Prior to that Mr. Bryan was the Controller of a private software company and worked as an auditor at Ernst & Young (Israel). Mr. Bryan is a Certified Public Accountant and holds a B.A. in Economics and Accounting from Haifa University.

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

*Sagee Aran.* Mr. Aran joined our company in March 2000 and has served as our Vice President of Sales for Asia Pacific and Africa since November 2003. Prior to that, Mr. Aran served as our Vice President of Professional Services. Prior to joining our company, he worked for seven years at HISH Ltd., a company specializing in process engineering and management, at which he held a number of positions including Operations Manager and International Sales and Marketing Manager. Mr. Aran holds a B.Sc. in Engineering from the Technion, Israel Institute of Technology.

*Danny Engle.* Mr. Engle is VP of North American Sales for Sentori. In his role, Mr. Engle has responsibilities for Sentori's North American Sales. 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; Director of Sales for SOTAS, a leading provider of network efficiency maximization tools for communication service providers. Mr. Engle holds a B.S. in Business Administration from the University of Texas.

*Tal Shain.* Mr. Shain joined our company 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.

*Rimon Ben-Shaoul.* Mr. Ben-Shaoul has served as a director of our company since August 2002. Mr. Ben-Shaoul has served as the President and CEO of Polar Communications Ltd. since 2004 and between 2001 and 2004 as the Co-Chairman, President and CEO of Koonras Technologies Ltd., an investment company controlled by Polar Investments Ltd. From 1997 to 2001 Mr. Ben-Shaoul served as the President and CEO of Clal Industries and Investments Ltd. Mr. Ben-Shaoul serves as Chairman of Cimatron Ltd. and Nipson Digital Printing Plc. and as a director of Nice Systems Ltd. and B.V.R. Technologies Ltd. and 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.

*Menahem Shalgi.* Mr. Shalgi has served as an external director of our company since April 2005. Mr. Shalgi served at Amdocs 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. Mr. Shalgi serves on the advisory board of a private company and as a director of a privately held company. Mr. Shalgi holds a B.A. degree in Economics and Statistics from Tel-Aviv University and a M.Sc. degree in Computer Science from Weizmann Institute for Science.

*Zamir Bar-Zion.* Mr. Bar-Zion has served as an external director of our company since June 2002. Since May 2006 to the present date, Mr. Bar-Zion is serving as the Managing Director of Investment Banking at Leumi & Co. Investment House in alliance with Jefferies Broadview. Mr. Bar-Zion has also served as the Managing Director of Investment Banking at Excellence Nessuah/Piper Jaffray from May 2004 to February 2006. Mr. Bar-Zion was a Managing Director for investment banking at Nessuah Zannex & Co. from 1998 to 2001. Mr. Bar-Zion currently serves as a director of the following three companies: Attunity Ltd., Lapidot Cheletz Ltd. and as a chairperson of Lapidot Ltd. Mr. Bar-Zion holds a B.S. degree in Computer Science and Finance from the New York Institute of Technology, an M.A. degree in Finance from Pace University and has graduated from the Program of Management Development at Harvard 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 2006 was approximately \$1.6 million, including approximately \$123,000 that was set aside for pension and retirement benefits. This does not include amounts expended 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 2006, options to purchase 208,000 ordinary shares were granted to our directors and executive officers under our option plans.

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 is 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 will vest in three equal annual installments on February 1, 2006, 2007 and 2008 and will expire on February 8, 2012. The shareholders also approved to pay each non-executive director an annual fee of \$8,000 and a participation fee of \$400 per meeting, which is the same amount of fees paid to our 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 2007, Class II in 2008 and Class III in 2009. Monica Eisinger is a member of Class I, Rimon Ben-Shaoul 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 one additional term 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. Zamir Bar-Zion was re-elected to a second term as an external director in April 2005, effective June 27, 2005. Mr. Menahem Shalgi was elected as an external director in April 2005.

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, that 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. Zamir Bar-Zion 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 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 if the person or the person's relative, partner, employer or any entity under the person's control has, as of the date of the person's appointment to serve as an external director, or had, during the two years preceding that date, any affiliation with:

- the company;
- any entity controlling the company; or
- any entity controlled by the company or by its controlling entity.

The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder.

The Companies Law defines the term "office holder" of a company to include a director, the chief executive officer, the chief business manager, a vice 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 may not engage an external director to serve as an office holder and cannot employ or receive services from that person, either directly or indirectly, including through a



corporation controlled by that person.

As mentioned above, the initial term of an external director is three years and may be extended for one additional term 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 the Company.

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

- at least one third of the shares of non-controlling shareholders voted at the meeting 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 one percent of the aggregate 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, but excluding:

- the chairman of the board of directors; and
- a controlling shareholder or a relative of a controlling shareholder and any director employed by the company or who provides services to the company on a regular basis.

Under the Companies Law, the role of the audit committee is to examine flaws in the management of the company's business, in consultation with the internal auditor and the company's independent accountants, suggest remedial measures, and to approve specified related party transactions. Our audit committee consists of all our external directors and Mr. Rimon Ben-Shaoul.

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 three 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 may not be an interested party, an office holder, or a relative of any of the foregoing, nor may the internal auditor be the company's independent accountant or its representative. The Companies Law defines the term "interested party" to include a person who holds 5% or more of the company's outstanding share capital or voting rights, a person who has the right to appoint one or more directors or the general manager, or any person who serves as a director or as the general manager. The accounting firm of Deloitte Touche Tohmatsu 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.

If the transaction is an extraordinary transaction, approval of both the audit committee and the board of directors is required. Under specific circumstances, shareholder approval may also be required. A director who has a personal interest in a transaction that is considered at a meeting of the board of directors or the audit committee generally may not be present at this meeting or vote on the matter, unless a majority of the members of the board of directors or the audit committee, as the case may be, has a personal interest in the matter. If a majority of members of the board of directors have a personal interest therein, shareholder approval is also required.

### **Disclosure of Personal Interests of a Controlling Shareholder**

Under the Companies Law, the disclosure requirements, which apply to an office holder, also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder that owns 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights, but excluding a shareholder whose power derives solely from his or her position on the board of directors or any other position with the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the engagement of a controlling shareholder as an office holder or employee, require the approval of the audit committee, the board of directors and the shareholders of the company, in that order. The shareholder approval must be by a majority of the shares voted on the matter, provided that either:

- at least one-third of the shares of shareholders who have no personal interest in the transaction and who vote on the matter vote in favor thereof; or
- the shareholders who have no personal interest in the transaction who vote against the transaction do not represent more than one percent of the voting rights in the company.

Shareholders generally have the right to examine any document in the company's possession pertaining to any matter that requires shareholder approval. If this information is made public in Israel or elsewhere, we will file the information with the Securities and Exchange Commission in the United States.

For information concerning the direct and indirect personal interests of an office holder and principal shareholders in specified transactions with us, see Item 7.B "Related Party Transactions."

### Remuneration of Members of the Board of Directors

Under the Companies Law, no director may be paid any remuneration by the company for his services as director except as may be approved by our audit committee, board of directors and shareholders. Our external directors are entitled to consideration and reimbursement of expenses only as provided in regulations promulgated under the Companies Law and are otherwise prohibited from receiving any other consideration, directly or indirectly, in connection with their service as external directors. The compensation paid to our directors is described above in Item 6.B. Our directors are not entitled to benefits upon termination of service.

### Executive Officers

Our executive officers are appointed by our board of directors and serve at the discretion of our board of directors. We maintain written employment agreements with our executive officers. Each agreement terminates upon 30 days' written notice and provides for standard terms and conditions of employment. All of our executive officers have agreed not to compete with us for 12 months (or 24 months in the case of Monica Eisinger) following the termination of their employment with us. Monica Eisinger is entitled to severance pay upon termination of her employment by either her or us (other than by us for cause) and to receive, during each month of the six-month period following termination of her employment by us, or by her for cause, an amount of salary and benefits equal to her former monthly salary and other benefits. Under recent Israeli case law, the non-competition undertakings of employees may not be enforceable.

### D. Employees

The numbers and breakdowns of our employees as of the end of the past three years are set forth in the following table:

	As of December 31,		
	2004	2005	2006
Approximate numbers of employees by geographic location			
Israel		105	99
Romania		140	159
United States		4	23
China		3	3
Total workforce		252	284
Approximate numbers of employees by category of activity			
General and administration		14	17
Research and development		154	162
Professional services and customer support		60	78
Sales and marketing		24	27
Total workforce		252	284

We are subject to Israeli labor laws and regulations with respect to our Israeli employees. These laws principally concern matters such as paid annual vacation, paid sick days, length of the work day and work week, minimum wages, pay for overtime, insurance for work-related accidents and severance payments upon the retirement or death of an employee or termination of employment under specified circumstances. The severance payments may be funded, in whole or in part, through Managers' Insurance or a Pension Fund, as described below. The payments to the Managers' Insurance fund or Pension Fund toward severance amount to 8.3% of wages. Furthermore, Israeli employees and

employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Since January 1, 1995, these amounts also include payments for health insurance. The payments to the National Insurance Institute amount to approximately 17.7% of wages, of which the employee contributes approximately two-thirds and the employer contributes approximately one-third.

Our general practice in Israel is to contribute funds on behalf of all of our employees to Managers' Insurance or a Pension Fund. Each employee who agrees to participate in the Managers' Insurance plan contributes 5% of his or her base salary and we contribute 13.3%. Each employee who agrees to participate in the Pension Fund contributes 5.0% or 5.5% of his or her base salary and we contribute 14.3%. Another savings plan we offer some of our employees, although not legally required, is known as the Advanced Studies Fund. Each employee who agrees to participate in the Advanced Studies fund contributes 2.5% of his or her base salary and we contribute 7.5%.

Furthermore, by order of the Israeli Ministry of Labor and Welfare, all employers and employees are subject to provisions of collective bargaining agreements between the Histadrut, Federation of Labor, and the Coordination Bureau of Economic Organizations in Israel. These provisions principally concern cost of living increases, recreation pay, commuting expenses and other conditions of employment. We provide our employees with benefits and working conditions above the required minimums. Our employees are not represented by a labor union. To date, we have not experienced any work stoppages and our relationships with our employees are good.

### **E. Share Ownership**

As of June 1, 2007, Monica Eisinger owned 4,094,000, or 19.0%, of our ordinary shares. In addition, as of such date, Ms. Eisinger held options to acquire 18,000 ordinary shares at an exercise price of \$3.82, which vest in equal installments on February 1, 2006, 2007 and 2008 and will expire on February 8, 2012.

None of our other directors or members of senior management beneficially owns 1% or more of our ordinary shares.

We have established stock option plans to provide for the issuance of options to our directors, officers and employees. Under the plans, options to purchase our ordinary shares may be issued from time to time to our directors, officers and employees at exercise prices and on other terms and conditions as determined by our board of directors. Our board of directors determines the exercise price and the vesting period of options granted.

The option plans permit the issuance of options to acquire up to 4,308,000 ordinary shares. As of June 1, 2007, options to purchase 1,114,010 ordinary shares were outstanding and options for 978,290 ordinary shares had been exercised. The options vest over three to five years, commencing on the date of grant. Generally, options not previously exercised will expire approximately seven years after they are granted. Our board of directors elected the capital gains treatment afforded under Section 102 of the Israeli Income Tax Ordinance [New Version], 1961, or the Tax Ordinance, in respect of options awarded under our Israeli option plan after January 1, 2003. Accordingly, gains derived from options awarded after January 1, 2003, and held by a trustee for at least two years from the end of the tax year in which they were awarded (or in some cases for 30 months from the date of grant), will generally be taxed as capital gains at a rate of 25%, and we will generally not be entitled to recognize an expense for the award of such options. For grants of options made on or after January 1, 2006, the aforesaid minimum holding period by the trustee is two years from the date of grant of the options. On April 13, 2004, our annual general meeting resolved to extend our share option plans until December 31, 2010.

## **Item 7. Major Shareholders and Related Party Transactions**

### **A. Major Shareholders**

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of June 1, 2007, unless otherwise specified, by each person who is known to own beneficially more than 5% of the

outstanding ordinary shares.

<b>Name of Beneficial Owners</b>	<b>Total Shares Beneficially Owned</b>	<b>Percentage of Ordinary Shares<sup>(1)</sup></b>
Monica Eisinger	4,106,000 <sup>(2)</sup>	19.0% <sup>(1)</sup>

1. Based on 21,592,510 ordinary shares outstanding on June 1, 2007

2. Includes 12,000 ordinary shares issuable upon the exercise of warrants that are exercisable on June 1, 2007 or within 60 days thereafter.

As of June 1, 2007, there were seven holders of record of our ordinary shares in the United States who collectively held less than 1% of our outstanding ordinary shares. In addition to this amount, there were also 12,981,939 shares held by the Depositary Trust Company in the United States. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees.

## **B. Related Party Transactions**

None.

## **C. Interests of Experts and Counsel**

Not applicable.

## **Item 8. Financial Information**

### **Financial Statements**

See Item 18.

### **Legal Proceedings**

We are not a party to any material legal proceedings.

### **Dividend Policy**

According to our dividend policy adopted in 2003, we plan to distribute a cash dividend once in each calendar year in an amount equal to our net profits for the preceding calendar year, if any. The new policy commenced in 2004 with respect to our net profits for 2003. Each dividend under the policy is subject to board approval and the requirements of applicable law. Our board of directors plans to declare the annual dividend when it approves the applicable year-end financial statements. There is no guarantee that we will have net profits in any given year, even if we have operating profit in that year.

## **Item 9. The Offer and Listing**

### **A. Offer and Listing Details**

Our ordinary shares have been quoted on the Nasdaq Global Market under the symbol MNDO since August 8, 2000 and on the Tel Aviv Stock Exchange under the symbol MIND since July 11, 2002.

The following table sets forth, for the periods indicated, the high and low closing prices of our ordinary shares as reported on the Nasdaq Global Market. The table contains actual prices in U.S. dollars, without adjustment for

dividends paid on our ordinary shares.

Period	High	Low
<b>Last six months:</b>		
May 2007	3.05	2.66
April 2007	3.03	2.77
March 2007	2.94	2.74
February 2007	3.02	2.62
January 2007	2.75	2.59
December 2006	2.76	2.59
<b>Last nine quarters:</b>		
Q1 2007	3.02	2.59
Q4 2006	2.83	2.47
Q3 2006	2.66	2.37
Q2 2006	3.18	2.40
Q1 2006	3.38	2.59
Q4 2005	2.89	2.56
Q3 2005	3.13	2.67
Q2 2005	3.95	2.69
Q1 2005	5.64	3.89

<b>Last five years:</b>		
2006	3.38	2.37
2005	5.64	2.56
2004	6.33	3.86
2003	6.34	1.24
2002	1.84	0.79

The following table sets forth, for the periods indicated, the high and low closing prices of our ordinary shares as reported on the Tel Aviv Stock Exchange. The table contains actual prices in NIS, without adjustment for dividends paid on our ordinary shares.

Period	High	Low
<b>Last six months:</b>		
May 2007	12.24	10.72
April 2007	12.40	11.44
March 2007	12.57	11.57
February 2007	12.97	11.22
January 2007	11.57	10.76
December 2006	11.33	10.89
<b>Last nine quarters:</b>		
Q1 2007	12.97	10.76
Q4 2006	12.27	10.74
Q3 2006	11.51	10.69
Q2 2006	14.59	10.40
Q1 2006	15.55	11.79
Q4 2005	13.23	11.66
Q3 2005	14.80	12.31
Q2 2005	17.89	12.18
Q1 2005	24.92	18.36
<b>Last five years:</b>		
2006	15.55	10.40
2005	24.92	11.66
2004	28.54	17.03
2003	27.94	5.00

2002 (From July 11)

5.90

5.00

**B. Plan Of Distribution**

Not applicable

**C. Markets**

Our ordinary shares are quoted on the Nasdaq Global Market under the symbol MNDO, and on the Tel-Aviv Stock Exchange under the symbol MIND.

**D. Selling Shareholders**

Not applicable

**E. Dilution**

Not applicable

**F. Expenses of the Issue**

Not applicable

**Item 10. Additional Information****A. Share Capital**

Not applicable

**B. Memorandum and Articles of Associations****Objects and Purposes**

We were first registered under Israeli law on April 6, 1995 as a private company, and on August 8, 2000 became a public company. Our registration number with the Israeli registrar of companies is 51-213448-7. The full details of our objects and purposes can be found in Section 2 of our Memorandum of Association filed with the Israeli registrar of companies. Among the objects and purposes stipulated are the following: "to engage in any kind of commercial and/or productive business and to engage in any action or endeavor which the company's managers consider to be beneficial to the company."

**Transfer of Shares and Notices**

Fully paid ordinary shares are issued in registered form and may be freely transferred pursuant to our articles of association unless such transfer is restricted or prohibited by another instrument. Unless otherwise prescribed by law, we will provide at least 21 calendar days' prior notice of any general shareholders meeting.

**Election of Directors**

The ordinary shares do not have cumulative voting rights in the election of directors. Thus, the holders of ordinary shares conferring more than 50% of the voting power have the power to elect all the directors, to the exclusion of the remaining shareholders. Our board is divided into three classes of directors serving staggered three-year terms, in addition to our external directors, who are not members of any class.



According to the Israeli Companies Law, the term of a director commences upon his election, unless the company's articles of association permit a later effective date. In order to allow our shareholders to elect a director for a term that commences on a later effective date, our shareholders amended our articles of association on April 7, 2005.

### **Dividend and Liquidation Rights**

Dividends on our ordinary shares may be paid only out of profits and other surplus, as defined in the Companies Law, as of our most recent financial statements or as accrued over a period of two years, whichever is higher, unless otherwise approved by a court order. Our board of directors is authorized to declare dividends, provided that there is no reasonable concern that the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to their respective holdings. Dividend or liquidation right may be affected by the grant of preferential dividends or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

### **Voting, Shareholders' Meetings and Resolutions**

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders.

These voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

We have two types of general shareholders meetings: the annual general meetings and extraordinary general meetings. These meetings may be held either in Israel or in any other place the board of directors determines. An annual general meeting must be held in each calendar year, but not more than 15 months after the last annual general meeting. Our board of directors may convene an extraordinary meeting, from time to time, at its discretion and is required to do so upon the request of shareholders holding at least 5% of our ordinary shares.

The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or by proxy who hold or represent between them at least 25% of the outstanding voting shares, unless otherwise required by applicable rules. Nasdaq generally requires a quorum of 33-1/3%, but we have an exemption from that requirement and instead follow the generally accepted business practice for companies in Israel. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the Chairman may designate with the consent of the shareholders voting on the matter adjourned. At such reconvened meeting, the required quorum consists of any two members present in person or by proxy, unless otherwise required by applicable rules.

Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority of the shares present, in person or by proxy, and voting on the matter. However, our articles of association require approval of 75% of the shares present and voting to remove directors or change the structure of our staggered board of directors.

We have obtained an exemption from Nasdaq's requirement to send an annual report to shareholders prior to our annual general meetings. We file annual reports on Form 20-F electronically with the SEC and post a copy on our website.

### **Duties of Shareholders**

Under the Companies Law, each and every shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations towards the company and other shareholders and to refrain from abusing his power in the

company, such as in voting in the general meeting of shareholders on the following matters:

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of certain actions and transactions which require shareholder approval.

In addition, each and every shareholder has the general duty to refrain from depriving rights of other shareholders. Furthermore, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the articles of association, has the power to appoint or to prevent the appointment of an office holder in the company or any other power toward the company is under a duty to act in fairness towards the company. The Companies Law does not describe the substance of this duty of fairness. These various shareholder duties, which typically do not apply to shareholders of U.S. companies, may restrict the ability of a shareholder to act in what the shareholder perceives to be its own best interests.

### **Restrictions on Non-Israeli Residents**

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

### **Mergers and Acquisitions under Israeli Law**

The Companies Law includes provisions that allow a merger transaction and requires that each company that is party to a merger approve the transaction by its board of directors and a vote of the majority of its shares, voting on the proposed merger at a shareholders' meeting. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares held by parties other than the other party to the merger, or by any person who holds 25% or more of the shares or the right to appoint 25% or more of the directors of the other party, vote against the merger. Upon the request of a creditor of either party of the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least (i) 50 days have passed from the time that a proposal of the merger has been filed by each party with the Israeli Registrar of Companies and (ii) 30 days have passed since the merger was approved by the shareholders of each party.

The Companies Law also provides that an acquisition of shares of public company must be made by means of tender offer if as a result of the acquisition the purchaser would become a 25% or more shareholder of the company and there is no 25% or more shareholder in the company. In addition, an acquisition of shares of a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or more shareholder of the company and there is no 45% or more shareholder in the company. These requirements do not apply if the acquisition (i) is made in a private placement that received shareholder approval, (ii) was from a 25% shareholder of the company and resulted in the acquirer becoming a 25% shareholder of the company or (iii) was from a 45% shareholder of the company and resulted in the acquirer becoming a 45% shareholder of the company. The tender offer must be extended to all shareholders, but the offer or is not required to purchase more than 5% of the company's outstanding shares, regardless of how many shares are tendered by shareholders. The tender offer may be consummated only if (i) at least 5% of the company's outstanding shares will be acquired by the offer or and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If as a result of an acquisition of shares the acquirer will hold more than 90% of a company's outstanding shares, the Companies Law requires that the acquisition be made by means of a tender offer for all of the outstanding shares. If as a result of a full tender offer the acquirer would own more than 95% of the outstanding shares, then all the shares that the acquirer offered to purchase will be transferred to it. The law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. If as a result of a full tender offer the acquirer would own 95% or less of the outstanding shares, then the acquirer may not acquire shares that will cause his shareholding to exceed 90% of the outstanding shares.

Finally, 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 subjects 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.

### **Modification of Class Rights**

Our articles of association provide that the rights attached to any class (unless otherwise provided by the terms of such class), such as voting, rights to dividends and the like, may be varied by a shareholders resolution, subject to the approval of the holders of a majority of the issued shares of that class.

### **Board of Directors**

According to the Companies Law and our articles of association, the oversight of the management of our business is vested in our board of directors. The board of directors may exercise all such powers and may take all such actions that are not specifically granted to our shareholders. As part of its powers, our board of directors may cause the company to borrow or secure payment of any sum or sums of money, at such times and upon such terms and conditions as it thinks fit, including the grants of security interests on all or any part of the property of the company.

A resolution proposed at any meeting of the board of directors shall be deemed adopted if approved by a majority of the directors present and voting on the matter. For additional information, please see Item 6.C "Board Practices".

### **Exculpation of Office Holders**

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

### **Insurance of Office Holders**

Our articles of association provide that, subject to the provisions of the Companies Law, we may enter into a contract for the insurance of the liability of any of our office holders, with respect to an act performed in the capacity of an office holder for:

- a breach of his duty of care to us or to another person;
- a breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice our interests; or
- a financial liability imposed upon him in favor of another person.

### **Indemnification of Office Holders**

Our articles of association provide that we may indemnify an office holder against the following obligations and expenses imposed on or incurred by the office holder with respect to an act performed in the capacity of an office holder:

- a financial obligation imposed on him in favor of another person by a court judgment, including a settlement or an arbitrator's award approved by the court; such indemnification may be approved (i) after the liability has been incurred or (ii) in advance, provided that our undertaking to indemnify is limited to events that our board of directors believes are foreseeable in light of our actual operations at the time of providing the undertaking and to a sum or criterion that our board of directors determines to be reasonable under the circumstances;
- reasonable litigation expenses, including attorneys' fees, expended by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against him and either (A) concluded without the imposition of any financial liability in lieu of criminal proceedings or (B) concluded with the imposition of a financial liability in lieu of criminal proceedings but relates to a criminal offense that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him by a court in connection with:
  - ◆ proceedings we institute against him or instituted on our behalf or by another person;
  - ◆ a criminal charge from which he was acquitted; or
  - ◆ a criminal proceeding in which he was convicted of an offense that does not require proof of criminal intent.

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

The Companies Law provides that a company may not exculpate or indemnify an office holder, or enter into an insurance contract, which would provide coverage for any monetary liability incurred as a result of any of the following:

- a breach by the office holder of his duty of loyalty unless, with respect to indemnification or insurance coverage, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach by the office holder of his duty of care if the breach was done intentionally or recklessly;
- any act or omission done with the intent to derive an illegal personal benefit; or
- any fine levied against the office holder.

In addition, under the Companies Law, indemnification of, and procurement of insurance coverage for, our office holders must be approved by our audit committee and our board of directors and, if the beneficiary is a director, by our shareholders.

We have agreed to exempt from liability and indemnify our office holders to the fullest extent permitted under the Companies Law. We have obtained directors and officers liability insurance for the benefit of our office holders.

### **C. Material Contracts**

None.

## **D. Exchange Controls**

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

## **E. Taxation**

### **Israeli Tax Considerations**

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us. Note that this tax structure and any resulting benefit may not apply for any income derived by our foreign subsidiaries, which subsidiaries may be taxed according to tax laws applicable to their country of residence. The following also contains a discussion of the material Israeli and United States tax consequences to persons purchasing our ordinary shares. To the extent that the discussion is based on tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or courts will accept the views expressed in the discussion in question.

Prospective purchasers of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

### **General Corporate Tax Structure**

The general rate of corporate tax in Israel to which Israeli companies are subject is 31% for the 2006 tax year and 29% for the 2007 tax year. Following an amendment to the Israeli Income Tax Ordinance that came into effect on January 1, 2006, the corporate tax rate is expected to decrease as follows: 27% for the 2008 tax year, 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter. The general rate of capital gains tax in Israel to which Israeli companies are subject is 25%, for capital gains derived after January 1, 2003 other than gains deriving from the sale of listed securities (regarding the last statement, it relates only to assets that were purchased after 1.1.03. If the asset was purchased before 1.1.03, and sold after said date, the applicable tax rate will be determined according to a blended tax rates of 25% and the corporate tax rate that was in forth on the date of the sale (based on a linear calculation)). However, the effective tax rate payable by a company which derives income from an "Approved Enterprise" (as defined below) may be considerably less, as further discussed below.

### **Law for the Encouragement of Capital Investments, 1959**

#### *General*

The Law for Encouragement of Capital Investments, 1959, or the Investments Law, as in effect until 2005, provided that upon application to the Investment Center of the Ministry of Industry and Trade of the State of Israel, a proposed capital investment in eligible facilities may be designated as an "Approved Enterprise". Please see discussion below regarding an amendment to the Investments Law.

Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income derived from the specific Approved Enterprise. Tax benefits under the Investments Law will also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the Approved Enterprise, income generated from royalties, and income derived from a service which is auxiliary to such

usage right of royalties, provided that such income is generated within the Approved Enterprise's ordinary course of business. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates. The benefits under the Investments Law are usually not available with respect to income derived from products manufactured outside of Israel.

Taxable income of a company derived from an Approved Enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. That income is eligible for further reductions in tax rates depending on the percentage of the foreign investment in the company's share capital (conferring rights to profits, voting and appointment of directors) and the percentage of its combined share and loan capital owned by non-Israeli residents ("foreign investment level"). The tax rate is:

- 20% if the foreign investment level is 49% or more but less than 74%;
- 15% if the foreign investment level is 74% or more but less than 90%; and
- 10% if the foreign investment level is 90% or more.

The lowest level of foreign investment during the tax year will be used to determine the relevant tax rate for that year. These tax benefits are granted for a limited period not exceeding seven years, or ten years for a company whose foreign investment level exceeds 25% from the first year in which the Approved Enterprise has taxable income.

The period of benefits may in no event, however, exceed the lesser of 12 years from the year in which production commenced and 14 years from the year of receipt of Approved Enterprise status.

The Investments Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program.

#### *The Alternative Route*

A company owning an Approved Enterprise may elect to receive, in lieu of certain grants available to an Approved Enterprise, an alternative package of benefits. Under the alternative package, the company's undistributed income derived from an Approval Enterprise will be exempt from tax for a period of between two and ten years from the first year of taxable income, depending on the geographic location of the Approved Enterprise within Israel, and the company will be eligible for the tax benefits under the Investments Law for the remainder of the benefit period.

#### *General Requirements by the Investment Center*

The benefits available to an Approved Enterprise are conditional upon compliance with the conditions stipulated in the Investments Law and related regulations and the criteria set forth in the specific certificate of approval. In the event that a company violates these conditions, in whole or in part, it may be required to refund all or a portion of its tax benefits, linked to the Israeli consumer price index and interest. These conditions include:

- adhering to the business plan contained in the application to the Investment Center;
- financing at least 30% of the investment in property, plant and equipment with the proceeds of the sale of shares;
- filing regular reports with the Investment Center with respect to the Approved Enterprise; and
- obtaining the approval of the Investment Center for changes in the ownership of a company.

*The Company's Approved Enterprises*

Most of our manufacturing facilities in Yoqneam have been granted the status of Approved Enterprise. Since our manufacturing facilities are located in an area that was designated by the State of Israel as "Development Area A" at the time of the approval of our three existing Approved Enterprises, and since we elected to receive the alternative package of benefits (involving waiver of investment grants), our income derived from each Approved Enterprise is tax exempt for a period of ten years commencing in the first year in which we earn taxable income from each Approved Enterprise. To date, we have three Approved Enterprises. The period of tax benefits of the first approved enterprise, which commenced operations in 1995, expired at the end of 2004. The period of tax benefits in respect of the second approved enterprise entitled to the said benefits commenced in 2000 and will expire at the end of 2009. The period of tax benefits in respect of the third approved enterprise has not yet commenced.

*Dividends Taxation*

When dividends are distributed from the Approved Enterprise, they are generally considered to be attributable to the entire enterprise and their effective tax rate is a result of a weighted combination of the applicable tax rates. A company that has elected the alternative package of benefits is not obliged to distribute exempt retained profits, and may generally decide from which year's profits to declare dividends. In the event that we pay a cash dividend from income that is derived from our Approved Enterprises pursuant to the alternative package of benefits, which income would otherwise be tax-exempt, we would be required to pay tax on the amount of income distributed as dividends at the rate which would have been applicable if we had not elected the alternative package of benefits, that rate is generally 10% to 25%, depending upon the extent of foreign investment in the Company, and to withhold at source on behalf of the recipient of the dividend an additional 15% of the amount distributed.

In March 2007, we distributed to our shareholders approximately \$4.3 million. Since, at that time we had insufficient retained earnings, the dividend was distributed after obtaining an approval by an Israeli court in accordance with Section 303 of the Israeli Companies Law. According to a pre-ruling received from the Israeli Tax Authority, tax was withheld at a rate of 20%. This pre-ruling applies only to this particular dividend and not to future dividends, if any.

*Amendment of the Investments Law*

On April 1, 2005, an amendment to the Investments Law came into effect. Pursuant to the amendment, a company's facility will be granted the status of "Approved Enterprise" only if it is proven to be an industrial facility (as defined in the Investments Law) that contributes to the economic independence of the Israeli economy and is a competitive facility that contributes to the Israeli gross domestic product. The amendment provides that the Israeli Tax Authority and not the Investment Center will be responsible for an Approved Enterprise under the alternative package of benefits, referred to as a Benefited Enterprise. A company wishing to receive the tax benefits afforded to a Benefited Enterprise is required to select the tax year from which the period of benefits under the Investment Law are to commence by simply notifying the Israeli Tax Authority within 12 months of the end of that year. In order to be recognized as owning a Benefited Enterprise, a company is required to meet a number of conditions set forth in the amendment, including making a minimal investment in manufacturing assets for the Benefited Enterprise and having completed a cooling-off period of no less than two to four years from the company's previous year of commencement of benefits under the Investments Law.

Pursuant to the amendment, a company with a Benefited Enterprise is entitled, in each tax year, to accelerated depreciation for the manufacturing assets used by the Benefited Enterprise and to certain tax benefits, provided that no more than 12 to 14 years have passed since the beginning of the year of commencement of benefits under the Investments Law. The tax benefits granted to a Benefited Enterprise, as they apply to us, are determined according one of the following new tax routes:

- Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10 to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of from seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%). The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and
- A special tax route enabling companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents; and

Generally, a company that is "abundant in foreign investment" (as defined in the Investments Law) is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The amendment changed the definition of "foreign investment" in the Investments Law so that instead of an investment of foreign currency in the company, the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company's outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition are retroactive from 2003.

The amendment applies to Approved Enterprise programs in which the year of commencement of benefits under the Investments Law is 2004 or later, unless such programs received approval from the Investment Center on or prior to December 31, 2004, in which case the provisions of the amendment will not apply.

As a result of the amendment, tax-exempt income that will be generated under the provisions of the amendment will subject the Company to taxes upon distribution or liquidation. Therefore, if the Company holds a Benefited Enterprise it may be required to record deferred tax liability with respect to such tax-exempt income.

#### **Law for the Encouragement of Industry (Taxes), 1969**

Under the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law, a company qualifies as an "Industrial Company" if it is resident in Israel and at least 90% of its income in a given tax year, determined in NIS, exclusive of income from capital gains, interest and dividends, is derived from Industrial Enterprises owned by that company. An "Industrial Enterprise" is defined as an enterprise whose major activity in a particular tax year is industrial production activity.

Industrial Companies qualify (based on tax regulations) for accelerated depreciation rates for machinery, equipment and buildings used by an Industrial Enterprise. An Industrial Company owning an Approved Enterprise, as described above, may choose between the above depreciation rates and the depreciation rates available to Approved Enterprises.

Pursuant to the Industry Encouragement Law, an Industrial Company is also entitled to amortize the purchase price of know-how and patents over a period of eight years beginning with the year in which such rights were first used.

In addition, an Industrial Company is entitled to deduct over a three-year period expenses involved with the issuance and listing of shares on a stock exchange and has the right, under certain conditions, to elect to file a consolidated tax return with related Israeli Industrial Companies that satisfy conditions set forth in the law.



Eligibility for the benefits under the law is not subject to receipt of prior approval from any governmental authority. We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. However, the definition may be amended from time to time and the Israeli tax authorities, which reassess our qualifications annually, may determine that we no longer qualify as an Industrial Company. As a result of either of the foregoing, the benefits described above might not be available in the future.

### **Taxation Under Inflationary Conditions**

The Income Tax (Inflationary Adjustment) Law, 1985, commonly referred to as the Inflationary Adjustments Law, attempts to overcome some of the problems presented to a traditional tax system by rapid inflation. The Inflationary Adjustments Law provides tax deductions and adjustments to depreciation deduction and tax loss carry forwards to mitigate the effects resulting from an inflationary economy. Our taxable income is determined under this law. The Inflationary Adjustments Law features, which may be material to us, can be summarized as follows:

- There is a special tax adjustment for the preservation of equity whereby some corporate assets are classified broadly into fixed assets and non-fixed assets. Where a company's equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.
- Subject to specific limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.

The Israeli Income Tax Ordinance and regulations promulgated thereunder allow "Foreign-Invested Companies," which maintain their accounts in U.S. dollars in compliance with the regulations to adjust their tax returns based on exchange rate fluctuations of the NIS against the U.S. dollar rather than changes in the Israeli consumer price index, or CPI, in lieu of the principles set forth by the Inflationary Adjustments Law. For these purposes, a Foreign-Invested Company is a company more than 25% of the share capital of which in terms of rights to profits, voting and appointment of directors, and of the combined share capital of which including shareholder loans and capital notes, is held by persons who are not residents of Israel. A company that elects to measure its results for tax purposes based on the U.S. dollar exchange rate cannot change the election for a period of three years following the election. We adjust our tax returns based on the changes in the Israeli CPI. Because we qualify as a "Foreign-Invested Company," we are entitled to measure our results for tax purposes on the basis of changes in the exchange rate of the U.S. dollar in future tax years.

### **Capital Gains Tax on the Sale of our Ordinary Shares**

#### *General*

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is equal to the increase in the purchase price of the relevant asset attributable to the increase in the Israeli consumer price index or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

#### *Israeli Residents*

Generally, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a "significant shareholder" at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate will be 25%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Inflationary Adjustments Law (or certain regulations) at the time of publication of the aforementioned amendment to the Tax Ordinance that came into effect on January 1, 2006, in which case the applicable tax rate is 25%. However, the foregoing tax rates will not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a taxpayer may elect the actual adjusted cost of the shares as the tax basis provided he can provide sufficient proof of such adjusted cost.

#### *Non-Residents of Israel*

Non-Israeli residents are generally exempt from Israeli capital gains tax on any gains derived from the sale of shares publicly traded on the TASE, provided such gains are not derived from a permanent establishment of such shareholders in Israel, and are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided that such capital gains are not attributed to a permanent establishment in Israel and that such shareholders are not subject to the Inflationary Adjustments Law and did not acquire their shares prior to the issuer's initial public offering. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary of or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

Furthermore, under the income tax treaty between the U.S. and Israel, known as the U.S.-Israel Tax Treaty, a holder of ordinary shares who holds the ordinary shares as a capital asset and who qualifies as a U.S. resident within the meaning of the U.S.-Israel Tax Treaty and who is entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty will be generally exempted from Israeli capital gains tax on the sale, exchange or disposition of ordinary shares unless: (i) the holder owned, directly or indirectly, 10% or more of our voting power at any time during the 12-month period before the sale, exchange or disposition; or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source. However, such residents would be permitted to claim a credit for such taxes against U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to state or local taxes.

A non-resident of Israel who receives dividend income or that realizes capital gains derived from the sale of our ordinary shares, from which tax was withheld at the source, is generally exempted from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer and the taxpayer has no other taxable sources of income in Israel.

#### *Dividend Taxation*

Income Taxes on Dividends Distributed by the Company to Israeli Residents

The distribution of dividend income to Israeli residents will generally be subject to income tax at a rate of 20% for individuals and will be exempt from income tax for corporations. The portion of dividends paid out of profits earned under an Approved Enterprise tax status of the Company, to both individuals and corporations, is subject to withholding tax at the rate of 15% (in excess of the corporate tax paid by the company when the dividend is paid of these profits - 25% tax).

In addition, If an Individual Israeli shareholder is considered a "principal shareholder" at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate on the dividend (not source from Approved Enterprise income) will be 25%. The withholding tax by the Company on such dividend would remain 20%.

#### Income Taxes on Dividends Distributed by the Company to Non-Israeli Residents

Subject to the provisions of applicable tax treaties, dividend distributions from regular profits (non-Approved Enterprise) by the Company to a non-resident shareholder are generally subject to withholding tax of 20%. The portion of dividends paid out of profits earned under an Approved Enterprise tax status of the Company is subject to withholding tax at the rate of 15% (in excess of the corporate tax paid by the company when the dividend is paid of these profits - 25% tax).

Generally, under the Tax Treaty Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income ("US Treaty") the maximum rate of withholding tax on dividends paid to a shareholder who is a resident of the United States (as defined in the US Treaty) will be 25%. Due to the fact that a tax rate of 25% is higher than the maximum Israeli tax rate on dividends pursuant to the 2006 Tax Reform, the maximum tax rate should be 20%. . However, when a U.S. tax resident corporation is the recipient of the dividend, the rate on a dividend out of regular (non-Approved Enterprise) profits may be reduced to 12.5% under the treaty, where the following conditions are met:

- a. the recipient corporation owns at least 10% of the outstanding voting rights of the Company for all of the period preceding the dividend during the Company's current and prior taxable year; and
- b. generally not more than 25% of the gross income of the paying corporation for its prior tax year consists of certain interest and dividend income.

Otherwise, the usual rates apply.

#### *U.S Residents*

Under the U.S.-Israel Tax Treaty, the maximum Israeli tax on dividends paid to a holder of ordinary shares who is a U.S. resident (as defined in the treaty) is 25%, and if such shareholder is a U.S. corporation holding at least 10% of the issued voting shares throughout the tax year in which the dividend is distributed as well as the previous tax year the tax rate is 12.5% (however this reduced rate will not apply if more than 25% of the Company's gross income consists of interest or dividends, other than dividends or interest received from subsidiary corporations), or 15% for dividends of income generated from an Approved Enterprise (or Benefited Enterprise).

#### **United States Federal Income Tax Considerations**

Subject to the limitations described in the next paragraph, the following discussion describes the material United States federal income tax consequences of the purchase, ownership and disposition of the ordinary shares to a U.S. holder.

A U.S. holder is:

- an individual citizen or resident of the United States;
- a corporation or another entity taxable as a corporation created or organized under the laws of the United States or any political subdivision thereof;
- an estate, the income of which is includable in gross income for United States federal income tax purposes regardless of its source; or
- a trust, if a United States court is able to exercise primary supervision over its administration and one or more United States persons who have the authority to control all substantial decisions of the trust.

Unless otherwise specifically indicated, this summary does not consider United States tax consequences to a person that is not a U.S. holder and considers only U.S. holders that will own the ordinary shares as capital assets.

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended, referred to as the Code, current and proposed Treasury regulations promulgated under the Code, and administrative and judicial interpretations of the Code, all as in effect today and all of which are subject to change, possibly with a retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder's particular circumstances, like the tax treatment of U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more of our outstanding voting shares, U.S. holders holding the ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, insurance companies, tax-exempt organizations, financial institutions and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the tax treatment of persons who hold the ordinary shares through a partnership or other pass through entity is not considered, nor are the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws.

You are advised to consult your own tax advisor with respect to the specific tax consequences to you of purchasing, holding or disposing of the ordinary shares.

### **Distributions on the Ordinary Shares**

Subject to the discussion below under "Passive Foreign Investment Company Status", a distribution paid by us with respect to the ordinary shares to a U.S. holder will be treated as ordinary income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of any distribution which exceeds these earnings and profits will be treated first as a non-taxable return of capital reducing the U.S. holder's tax basis in its ordinary shares to the extent thereof, and then as capital gain from the deemed disposition of the ordinary shares.

Dividends paid by us in NIS will be included in the income of U.S. holders at the dollar amount of the dividend, based upon the spot rate of exchange in effect on the date of the distributions. U.S. holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that U.S. dollar value. Any subsequent gain or loss in respect of the NIS arising from exchange rate fluctuations will be taxable as ordinary income or loss and will be U.S. source income or loss.

Subject to the limitations set forth in the Code, U.S. holders may elect to claim as a foreign tax credit against their U.S. federal income tax liability the Israeli income tax withheld from dividends received in respect of the ordinary shares. The limitations on claiming a foreign tax credit include among others, computation rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income payable with respect each such class. In this regard, dividends paid by us will generally be foreign source "passive income" for U.S. foreign tax credit purposes or, in the case of a financial services entity, "financial services income." U.S. holders that

do not elect to claim a foreign tax credit may instead claim a deduction for the Israeli income tax withheld. The rules relating to foreign tax credits are complex, and you should consult your own tax advisor to determine whether and to what extent you would be entitled to this credit.

### **Disposition of Ordinary Shares**

Subject to the discussion below under "Passive Foreign Investment Company Status", upon the sale or exchange of the ordinary shares, a U.S. holder generally will recognize capital gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the U.S. holder's tax basis in the ordinary shares. The gain or loss recognized on the sale or exchange of the ordinary shares generally will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the sale or exchange.

Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

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

Generally, a foreign corporation is treated as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for any tax year if, in such tax year, either (i) 75% or more of its gross income is passive in nature, referred to as the "Income Test", or (ii) the average percentage of its assets during such tax year which produce, or are held for the production of, passive income (determined by averaging the percentage of the fair market value of its total assets which are passive assets as of the end of each quarter of such year) is 50% or more, referred to as the "Asset Test".

There is no definitive method prescribed in the Code, U.S. Treasury Regulations or administrative or judicial interpretations thereof for determining the value of a foreign corporation's assets for purposes of the Asset Test. However, the legislative history of the U.S. Taxpayer Relief Act of 1997, referred to as the 1997 Act, indicates that for purposes of the Asset Test, "the total value of a publicly-traded foreign corporation's assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities". It is unclear under current interpretations of the 1997 Act whether other approaches could be employed to determine the value of our assets. Based on application of the approach of the 1997 Act, there is a reasonable likelihood that we may not be deemed a PFIC starting 2003. A separate determination must be made each year as to whether we are a PFIC. As a result, our PFIC status may change.

If we are treated as a PFIC for U.S. federal income tax purposes for any year during a U.S. holder's holding period of ordinary shares and the U.S. holder does not make a QEF election or a "mark-to-market" election (both as described below), any gain recognized by the U.S. holder upon the sale of ordinary shares (or the receipt of certain distributions) would be treated as ordinary income. This income generally would be allocated over a U.S. holder's holding period with respect to our ordinary shares. The amount allocated to prior years will be subject to tax at the highest tax rate in effect for that year and an interest charge would be imposed on the amount of deferred tax on the income allocated to prior taxable years.

Although we generally will be treated as a PFIC as to any U.S. holder if we are a PFIC for any year during the U.S. holder's holding period, if we cease to satisfy the requirements for PFIC classification, the U.S. holder may avoid the consequences of PFIC classification for subsequent years if he elects to recognize gain based on the unrealized appreciation in the ordinary shares through the close of the tax year in which we cease to be a PFIC. Additionally, if we are treated as a PFIC, a U.S. holder who acquires ordinary shares from a decedent would be denied the normally available step-up in tax basis for these ordinary shares to fair market value at the date of death and instead would have a tax basis equal to the decedent's tax basis in these ordinary shares.

A U.S. holder who beneficially owns shares of a PFIC must file Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund) with the U.S. Internal Revenue Service for each tax year in which he holds shares in a PFIC. This form describes any distributions received with respect to these shares and any gain realized upon the disposition of these shares.

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

A shareholder may make a QEF election with respect to a PFIC for any taxable year of the shareholder. A QEF election is effective for the year in which the election is made and all subsequent taxable years of the shareholder. Procedures exist for both retroactive elections and the filing of protective statements. A U.S. holder making the QEF election must make the election on or before the due date, as extended, for the filing of the shareholder's income tax return for the first taxable year to which the election will apply.

A U.S. holder must make a QEF election by completing Form 8621 and attaching it to their U.S. federal income tax return, and must satisfy additional filing requirements each year the election remains in effect. We will provide to each shareholder, upon request, the tax information required to make a QEF election and to make subsequent annual filings

As an alternative to a QEF election, a U.S. holder generally may elect to mark his ordinary shares to market annually, recognizing ordinary income or loss (subject to certain limitations) equal to the difference between the fair market value of his ordinary shares and the adjusted tax basis of his ordinary shares. Losses would be allowed only to the extent of net mark-to-market gain accrued under the election. If a mark-to-market election with respect to ordinary shares is in effect on the date of a U.S. holder's death, the normally available step-up in tax basis to fair market value will not be available. Rather, the tax basis of the ordinary shares in the hands of a U.S. holder who acquired them from a decedent will be the lesser of the decedent's tax basis or the fair market value of the ordinary shares.

The implementation of many aspects of the Code's PFIC rules requires the issuance of regulations which in many instances have yet to be promulgated and which may have retroactive effect. We cannot be sure that any of these regulations will be promulgated or, if so, what form they will take or what effect they will have on the foregoing discussion.

Accordingly, and due to the complexity of the PFIC rules, U.S. holders should consult their own tax advisors regarding our status as a PFIC for each year and the eligibility, manner and advisability of making a QEF election or a mark-to-market election, and the effect of these elections on the calculation of the amount of foreign tax credit that may be available to a U.S. holder.

### **Backup Withholding**

A U.S. holder may be subject to backup withholding at rate of 31% with respect to dividend payments and receipt of the proceeds from the disposition of the ordinary shares. Backup withholding will not apply with respect to payments made to certain exempt recipients, such as corporations and tax-exempt organizations, or if a U.S. holder provides a tax payer identification number (or certifies that he has applied for a taxpayer identification number), certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder, or alternatively, the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

### **Non-U.S. Holders of Ordinary Shares**

Except as provided below, a non-U.S. holder of ordinary shares except certain former U.S. citizens and long-term residents of the United States generally will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, and the proceeds from the disposition of, an ordinary share, unless such item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States or, in the case of a resident of a country which has an income tax treaty with the United States, such item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the payment of dividends on ordinary shares unless the payment is made through a paying agent, or an office of a paying agent, in the United States. Non-U.S. holders generally will be subject to information reporting and, under regulations generally effective January 1, 2001, to backup withholding at a rate of 31% with respect to the payment within the United States of dividends on the ordinary shares unless the holder provides its taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

Non-U.S. holders generally will be subject to information reporting and backup withholding at a rate of 31% on the receipt of the proceeds from the disposition of the ordinary shares to, or through, the United States office of a broker, whether domestic or foreign, unless the holder provides a taxpayer identification number, certifies to its foreign status or otherwise establishes an exemption. Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the receipt of proceeds from the disposition of the ordinary shares by a foreign office of a broker; provided, however, that if the broker is a U.S. person or a "U.S. related person," information reporting (but not backup withholding) will apply unless the broker has documentary evidence in its records of the non-U.S. holder's foreign status or the non-U.S. holder certifies to its foreign status under penalties of perjury or otherwise establishes an exemption. For this purpose, a "U.S. related person" is a broker or other intermediary that maintains one or more enumerated U.S. relationships. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder, or alternatively, the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

### **F. Dividends and paying agents**

Not applicable.

### **G. Statement by Experts**

Not applicable.

### **H. Documents on Display**

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, applicable to foreign private issuers and fulfill the obligations with respect to such requirements by filing reports with the Securities and Exchange Commission, or SEC. You may read and copy any document we file, including any exhibits, with the SEC without charge at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the SEC at such address, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Certain of our SEC filings are also available to the public at the SEC's website at <http://www.sec.gov>.

You may request a copy of our SEC filings, at no cost, by e-mailing to investor@mindcti.com and upon said request copies will be sent by e-mail. A copy of each report submitted in accordance with applicable U.S. law is available for review at our principal executive offices.

## I. Subsidiary Information

Not applicable.

### Item 11. Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the risk of changes in the value of our financial instruments as a result of fluctuations in foreign currency exchange rates.

The following table sets forth our consolidated balance sheet exposure with respect to change in foreign currency exchange rates as of December 31, 2006.

Currency	Current Monetary Assets (Liabilities) - net
	(In US \$ thousands)
NIS	(1,192)
Euro	2,962
Romanian Ron	(232)
Other non-dollar currencies	113
	1,651

Our annual expenses paid in NIS are approximately \$7 million. Accordingly, we estimate that a hypothetical increase of the value of the NIS against the U.S. dollar by 1% would result in an increase in our operating expenses by approximately \$70,000 for the year ended December 31, 2007.

During the last quarter of 2004, we deposited an amount of \$30 million with several banks for periods between seven and ten years. The arrangements with the banks are described above in Item 5.B.

As of December 31, 2006, we did not hold any instruments that are subject to risk arising from changes in equity prices. Also, we did not hold any derivative financial instruments for either trading or non-trading purposes.

### Item 12. Description of Securities Other Than Equity Securities

Not applicable.

## PART II

### Item 13. Defaults, Dividend Arrearages and Delinquencies

Not applicable.

### Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

The effective date of our first registration statement, filed on Form F-1 under the Securities Act of 1933 (No. 333-12266) relating to the initial public offering of our ordinary shares, was August 7, 2000. Net proceeds to us were \$29.9 million. From the time of receipt through December 31, 2006, all proceeds have been invested in bank deposits.



**Item 15. Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2006. Based on this evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be included in our periodic reports to the Securities and Exchange Commission is recorded, processed, summarized and reported in a timely manner.

In addition, there were no changes in our internal control over financial reporting that occurred during 2006 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

**Item 16A. Audit Committee Financial Expert**

Our board of directors has designated Mr. Zamir Bar-Zion as our "audit committee financial expert" as defined by the SEC rules.

**Item 16B. Code of Ethics**

In April 2004, our board of directors adopted our Code of Ethics, a code that applies to all of our directors and employees.

**Item 16C. Principal Accountant Fees and Services**

In the annual meeting held in June 2006, our shareholders re-appointed Kesselman & Kesselman, certified public accountants in Israel and a member of PricewaterhouseCoopers International Limited, to serve as our independent auditors. These accountants billed the following fees to us for professional services in each of the last two fiscal years:

	Years ended December 31,	
	2005	2006
Audit Fees	\$ 55,000	\$ 55,000
Audit-Related Fees	0	0
Tax Fees	5,000	5,000
All Other Fees	0	0
<b>Total</b>	<b>\$ 60,000</b>	<b>\$ 60,000</b>

Tax Fees. Services comprising fees disclosed under this category includes: preparation of original and amended tax returns; claims for refund; tax advice and assistance related to: dividend distribution, approved enterprise and tax audits and appeals.

Our audit committee's policy is to approve each audit and non-audit service to be performed by our independent accountant before the accountant is engaged.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Not applicable.

## PART III

### Item 17. Financial Statements

Not applicable.

### Item 18. Financial Statements

Our consolidated financial statements and related auditors' report for the year ended December 31, 2006 are hereby incorporated into this Annual Report by reference to our Report on Form 6-K furnished to the Securities and Exchange Commission on June 6, 2007.

### Item 19. Exhibits

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

Exhibit No.	Exhibit
1.1*	Memorandum of Association, as amended
1.2***	Articles of Association, as amended
4.1**	MIND 1998 Share Option Plan
4.2**	MIND 2000 Share Option Plan
8***	List of Subsidiaries
10.1	Consent of Kesselman & Kesselman
11**	Code of Ethics and Business Conduct
12.1	Certification of Principal Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act
12.2	Certification of Principal Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act
13.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act
13.2	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act

\* Incorporated by reference to MIND C.T.I. Ltd.'s Annual Report on Form 20-F for the fiscal year ended December 31, 2002 (Commission file number 000-31215).

\*\* Incorporated by reference to MIND C.T.I. Ltd.'s Annual Report on Form 20-F for the fiscal year ended December 31, 2003 (Commission file number 000-31215).

\*\*\* Incorporated by reference to MIND C.T.I. Ltd.'s Annual Report on Form 20-F for the fiscal year ended December 31, 2005 (Commission file number 000-31215).

## SIGNATURES

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

MIND CTI LTD.

*/s/ Monica Eisinger*

=====

By: Monica Eisinger  
Title: President & CEO  
Date: 06/27/07

**EXHIBIT 10.1**  
**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in this Registration Statements on Form S-8 (Registration No. 333-117054; No. 333-100804 and No. 333-54632) of our report dated June 6, 2007 relating to the 2006 consolidated financial statements of MIND C.T.I. Ltd., which are incorporated by reference in this Form 20-F.

/s/ Kesselman & Kesselman

Tel-Aviv, Israel  
June 27, 2007

Kesselman & Kesselman  
Certified Public Accountants (Isr.)

**EXHIBIT 12.1**

**Certification of Principal Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act**

I, Monica Eisinger, President and Chief Executive Officer of MIND C.T.I. Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of MIND C.T.I. Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the company and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. *[Paragraph omitted pursuant to SEC Release Nos. 33-8618 and 34-52492]*
  - c. evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: June 27, 2007

/s/ Monica Eisinger

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Monica Eisinger  
President and Chief Executive Officer

(Principal Executive Officer)

**Exhibit 12.2**

Certification of Principal Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act

I, Oren Bryan, Chief Financial Officer of MIND C.T.I. Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of MIND C.T.I. Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the company and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. *[Paragraph omitted pursuant to SEC Release Nos. 33-8618 and 34-52492]*
  - c. evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

/s/ Oren Bryan

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Oren Bryan  
Chief Financial Officer  
(Principal Financial Officer)

Date: June 27, 2007

**Exhibit 13.1**

Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act

In connection with the annual report on Form 20-F for the fiscal year ended December 31, 2006 of MIND C.T.I. Ltd. (the "Company") as filed with the U.S. Securities and Exchange Commission (the "Commission") on the date hereof (the "Report") and pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act

of 2002, I, Monica Eisinger, President and Chief Executive Officer of the Company, certify that:

- the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 27, 2007

/s/ Monica Eisinger

Monica Eisinger  
President and Chief Executive Officer  
(Principal Executive Officer)

**Exhibit 13.2**

Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act

In connection with the annual report on Form 20-F for the fiscal year ended December 31, 2006 of MIND C.T.I. Ltd. (the "Company") as filed with the U.S. Securities and Exchange Commission (the "Commission") on the date hereof (the "Report") and pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, Oren Bryan, Chief Financial Officer of the Company, certify that:

- the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 27, 2007

/s/ Oren Bryan

Oren Bryan  
Chief Financial Officer  
(Principal Financial Officer)