MILESTONE SCIENTIFIC INC.
Form 10-Q
November 14, 2018

**FORM 10-Q**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarter ended September 30, 2018**

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 001-14053

**Milestone Scientific Inc.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **13-3545623** |
| **State or other jurisdiction of Incorporation or organization** | **(I.R.S. Employer Identification No.)** |

**220 South Orange Avenue, Livingston, NJ 07039**

**(Address of principal executive offices)**

**Registrant's telephone number, including area code: 973-535-2717**

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $.001 per share | NYSE American |

**Securities registered pursuant to section 12(g) of the Act: NONE**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer (Do not check if a smaller reporting company) | Smaller reporting company |
| Emerging growth company | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 14, 2018, the registrant has a total of 33,825,701 shares of Common Stock, $0.001 par value outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

None

**MILESTONE SCIENTIFIC INC.**

**Form 10-Q**

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**FORWARD-LOOKING STATEMENTS**

*When used in this Quarterly Report on Form 10-Q, the words “may”, “will”, “should”, “expect”, “believe”, “anticipate”, “continue”, “estimate”, “project”, “intend” and similar expressions are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) regarding events, conditions and financial trends that may affect Milestone Scientific’s future plans of operations, business strategy, results of operations and financial condition. Milestone Scientific wishes to ensure that such statements are accompanied by meaningful cautionary statements pursuant to the safe harbor established in the Private Securities Litigation Reform Act of 1995. Prospective investors are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties and the actual results may differ materially from those included within the forward-looking statements because of various factors. Such forward-looking statements should, therefore, be considered regarding various important factors, including those set forth herein and others set forth from time to time in Milestone Scientific’s reports, including without limitations, Milestone Scientific's Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission (the “SEC”). Milestone Scientific disclaims any intent or obligation to update such forward-looking statements.*

Milestone Scientific is the owner of the following registered U.S. trademarks: *CompuDent®; CompuMed®; CompuFlo®; DPS Dynamic Pressure Sensing technology®; Milestone Scientific ®; the Milestone logo ®; SafetyWand®; STA Single Tooth Anesthesia Device®; and The Wand ®.*

**PART I—FINANCIAL INFORMATION**

Item 1. Financial Statements

MILESTONE SCIENTIFIC INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

| ASSETS | September 30, 2018 (Unaudited) | December 31, 2017 (Audited) |
|---|---|---|
| Current Assets: | | |
| Cash and cash equivalents | $414,829 | $2,636,956 |
| Accounts receivable, net | 1,014,166 | 1,535,513 |
| Accounts receivable, related party | 1,258,995 | 1,725,450 |
| Note receivable from financing transaction, current | - | 500,000 |
| Prepaid expenses and other current assets | 446,264 | 436,410 |
| Deferred cost, related party | 790,190 | 1,109,671 |
| Inventories, net | 2,245,958 | 3,379,209 |
| Advances on contracts | 884,823 | 697,192 |
| Total current assets | 7,055,225 | 12,020,401 |
| Furniture, fixtures & equipment, net | 94,590 | 141,760 |
| Patents, net | 448,528 | 2,789,748 |
| Note receivable from financing transaction, noncurrent | - | 650,000 |
| Other assets | 26,878 | 26,878 |
| Total assets | $7,625,221 | $15,628,787 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | $1,306,523 | $977,623 |
| Accounts payable, related party | 1,453,030 | 985,678 |
| Accrued expenses and other payables | 2,003,094 | 2,179,268 |
| Accrued expenses, related party | 64,748 | 108,640 |
| Deferred profit, related party | 492,884 | 751,500 |
| Deferred revenue, related party | 1,258,995 | 1,725,450 |
| Total current liabilities | 6,579,274 | 6,728,159 |
| Deferred gain from financing transaction | - | 1,400,000 |
| Total liabilities | $6,579,274 | $8,128,159 |
| | | |
| Commitments and Contingencies | | |
| | | |
| Stockholders' Equity | | |
| | $7 | $7 |

| | | |
|---|---|---|
| Series A convertible preferred stock, par value $.001, authorized 5,000,000 shares, and 7,000 shares issued and outstanding | | |
| Common stock, par value $.001; authorized 50,000,000 shares; 33,748,226 shares issued,1,909,175 shares to be issued and 33,714,893 shares outstanding as of September 30, 2018; 33,191,571 shares issued, 1,401,247 shares to be issued and 33,158,238 shares outstanding as of December 31, 2017; | 35,655 | 34,593 |
| Additional Paid in Capital | 87,971,298 | 86,689,084 |
| Accumulated deficit | (86,179,797) | (78,568,284) |
| Treasury stock, at cost, 33,333 shares | (911,516 ) | (911,516 ) |
| Total Milestone Scientific Inc. stockholders' equity | 915,647 | 7,243,884 |
| Noncontrolling interest | 130,300 | 256,744 |
| Total stockholders’ equity | $1,045,947 | $7,500,628 |
| Total liabilities and stockholders’ equity | $7,625,221 | $15,628,787 |

See notes to Condensed Consolidated Financial Statements

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MILESTONE SCIENTIFIC INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Product sales, net | $1,622,246 | $2,853,813 | $5,856,351 | $9,066,550 |
| Cost of products sold | 1,742,451 | 1,044,540 | 3,326,341 | 3,320,411 |
| Gross profit (loss) | (120,205) | 1,809,273 | 2,530,010 | 5,746,139 |
| | | | | |
| Selling, general and administrative expenses | 2,886,081 | 3,205,996 | 8,748,485 | 8,996,092 |
| Research and development expenses | 1,500 | 16,884 | 215,655 | 241,964 |
| Impairment of long lived assets | 1,539,794 | - | 1,539,794 | - |
| Total operating expenses | 4,427,375 | 3,222,880 | 10,503,934 | 9,238,056 |
| Loss from operations | (4,547,580) | (1,413,607) | (7,973,924) | (3,491,917) |
| Other expenses | (1,784) | (1,046) | (5,239) | (3,278) |
| Interest income | 1,544 | 3,582 | 6,135 | 6,495 |
| Loss before provision for income taxes and equity in net losses of equity investments | (4,547,820) | (1,411,071) | (7,973,028) | (3,488,700) |
| Provision for income taxes | (1,622) | (6,475) | (17,160) | (18,339) |
| Loss before equity in net losses of equity investments | (4,549,442) | (1,417,546) | (7,990,188) | (3,507,039) |
| (Loss) Earnings on earnings from Milestone Education | 1,635 | - | 1,635 | - |
| Earnings (Loss) from China Joint Venture | 143,242 | - | 258,616 | (28,941) |
| Net loss | (4,404,565) | (1,417,546) | (7,729,937) | (3,535,980) |
| Net loss attributable to noncontrolling interests | 11,742 | 6,605 | 118,424 | 138,915 |
| Net loss attributable to Milestone Scientific Inc. | $(4,392,823) | $(1,410,941) | $(7,611,513) | $(3,397,065) |
| | | | | |
| Net loss per share applicable to common stockholders— | | | | |
| Basic | $(0.12) | $(0.04) | $(0.22) | $(0.10) |
| Diluted | $(0.12) | $(0.04) | $(0.22) | $(0.10) |
| | | | | |
| Weighted average shares outstanding and to be issued— | | | | |
| Basic | 35,586,995 | 33,573,676 | 35,086,822 | 32,501,221 |
| Diluted | 35,586,995 | 33,573,676 | 35,086,822 | 32,501,221 |

See notes to Condensed Consolidated Financial Statements

MILESTONE SCIENTIFIC INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS'EQUITY

(UNAUDITED)

| | Preferred Stock Shares | Preferred Stock Amount | Common Stock Shares | Common Stock Amount | Additional Paid in Capital | Accumulated Deficit | Noncontrolling interest | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|---|---|
| Balance, January 1, 2018 | 7,000 | $7 | 34,592,818 | $34,593 | $86,689,084 | $(78,568,284) | $256,744 | $(911,516) | $7,500,628 |
| Stock based compensation | - | - | | | 247,425 | - | - | - | 247,425 |
| Common stock to be issued to employee for bonuses | - | - | 422,120 | 422 | 414,078 | - | - | - | 414,500 |
| Common stock issued for payment of consulting services | - | - | 350,103 | 349 | 289,401 | - | - | - | 289,750 |
| Common stock to be issued to employee for compensation | - | - | 47,401 | 47 | 44,953 | - | - | - | 45,000 |
| Common stock issued for Asset Acquisition | - | - | 244,959 | 244 | 286,357 | - | - | - | 286,601 |
| Acquired controlling interest in Milestone Education | - | - | - | - | - | - | (8,020) | - | (8,020) |
| Net loss | - | - | - | - | - | (7,611,513) | (118,424) | - | (7,729,937) |
| Balance as September 30, 2018 | 7,000 | $7 | 35,657,401 | $35,655 | $87,971,298 | $(86,179,797) | $130,300 | $(911,516) | $1,045,947 |

See notes to Condensed

Consolidated
Financial Statements

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MILESTONE SCIENTIFIC INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net loss | $(7,729,937) | $(3,535,980) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation expense | 53,675 | 44,046 |
| Amortization of patents | 801,426 | 187,209 |
| Impairment to long lived assets | 1,539,794 | - |
| Stock compensation | 247,425 | 530,966 |
| Equity (income) loss on China joint venture | (258,616) | 28,941 |
| Inventory reserve | 728,017 | - |
| Deferred cost reserve | 790,189 | - |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in accounts receivable | 521,347 | (1,197,252) |
| Decrease in accounts receivable, related party | 466,455 | 2,001,800 |
| Decrease in other receivables | - | 10,000 |
| Decrease in inventories | 405,234 | 436,998 |
| Increase in advances on contracts | (187,631) | (291,342) |
| Increase in prepaid expenses and other current assets | (9,854) | (260,081) |
| Increase in other assets | - | (9,523) |
| Increase (decrease) in accounts payable | 328,900 | (725,170) |
| Increase (decrease) in accounts payable, related party | 467,352 | (332,711) |
| (Decrease) increase in deferred cost, related party | (470,708) | 257,323 |
| Increase in accrued expenses | 859,677 | 1,583,624 |
| Decrease in accrued expenses, related party | (43,892) | - |
| Decrease in deferred revenue, related party | (466,455) | (289,000) |
| Net cash used in operating activities | (1,957,602) | (1,560,152) |
| Cash flows from investing activities: | | |
| Purchase of intangible assets | - | (39,520) |
| Purchase of property and equipment | (6,505) | (4,749) |
| Acquisition of Milestone Education | (8,020) | - |
| Purchase of intangibles assets-Apad | - | (153,647) |
| Net cash used in investing activities | (14,525) | (197,916) |
| Cash flows from financing activities: | | |
| Proceeds (payments) financing transaction | (250,000) | 250,000 |
| Proceeds from exercise of stock options | - | 62,500 |
| Net proceeds on Private Placement Offering | - | 150,836 |
| Net cash (used in) provided by financing activities | (250,000) | 463,336 |
| Net decrease in cash and cash equivalents | (2,222,127) | (1,294,732) |
| Cash and cash equivalents at beginning of period | 2,636,956 | 3,602,229 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $414,829 | $2,307,497 |
| | | |
| Supplemental disclosure of cash flow information: | | |
| Shares issued to employees for bonuses | $47,401 | $259,841 |
| Shares issued to consultants in lieu of cash payments | $350,103 | $422,249 |
| Shares issued for assets acquired | $- | $2,484,354 |
| Sale of Milestone China share, financing transaction | $(1,400,000) | $1,400,000 |

See notes to Condensed Consolidated Financial Statements

**MILESTONE SCIENTIFIC INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 1 — ORGANIZATION AND BUSINESS**

All references in this report to "Milestone Scientific," "us," "our," "we," the "Company" or "Milestone" refer to Milestone Scientific Inc., and its consolidated subsidiaries, Wand Dental, Inc., Milestone Advanced Cosmetic Devices, Inc., Milestone Medical, Inc. and Milestone Education LLC (all described below), unless the context otherwise indicates. Milestone Scientific is the owner of the following registered U.S. trademarks: C*ompuDent®; CompuMed®; CompuFlo®; DPS Dynamic Pressure Sensing technology®; Milestone Scientific ®; the Milestone logo ®; SafetyWand®; STA Single Tooth Anesthesia Device®; and The Wand ®.*

Milestone Scientific was incorporated in the State of Delaware in August 1989. Milestone Scientific has developed a proprietary, computer-controlled anesthetic delivery device, using *The Wand*®, a single use disposable handpiece. The device is marketed in dentistry under the trademark *CompuDent*®*,* and *STA Single Tooth Anesthesia Device*® and in medicine under the trademark *CompuMed*®. *CompuDent*® is suitable for all dental procedures that require local anesthetic. *CompuMed*® is suitable for many medical procedures regularly performed in plastic surgery, hair restoration surgery, podiatry, colorectal surgery, dermatology, orthopedics and many other disciplines. The dental devices are sold in the United States, Canada and in 53 other countries. To date, there have been minimal sales of the Company's medical devices in the United States and Europe.

During 2016, Milestone Scientific filed for 510(k) marketing clearance with the U.S. Food and Drug Administration (FDA) for both intra-articular and epidural injections with the *CompuFlo*® Computer Controlled Anesthesia System (the "*CompuFlo* Epidural System"). In June 2017, the FDA approved the *CompuFlo* Epidural System for epidural injections. Milestone Scientific is in the process of meeting with medical device distributors within the United States and foreign markets. Milestone Scientific's immediate focus is on marketing its epidural device throughout the United States and Europe.

In December 2016, we received notification from the FDA that based upon the 510(k)-application submitted for intra-articular injections, we did not adequately document that the device met the equivalency standard required for 510(k) clearances. Following consultation with the FDA Office of Device Evaluation, we filed a new 510(k) application for the device in June 2018. In August 2018, the FDA provided Milestone Scientific with a list of questions on the intra-articular 510(k) application filed in June 2018. Milestone Scientific is in the process of reviewing and responding to FDA questions.

**NOTE 2 — GOING CONCERN AND LIQUIDITY**

In accordance with Accounting Standard Codification (“ASC”) 205-40, “Presentation of Financial Statements – Going Concern”, the Company has evaluated whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the condensed consolidated financial statements are issued. Milestone Scientific has incurred operating losses and negative cash flows from operating activities in virtually each year since its inception.  Additionally, there has been delayed payments for shipments made to Milestone China in 2017 and 2018. These factors raise substantial doubt regarding the Company’s ability to continue as a going concern.

Milestone Scientific is actively pursuing the generation of positive cash flows from operating activities through an increase in revenue from its dental business worldwide, the generation of revenue from its medical devices and disposables business in the United States and worldwide, and a reduction in operating expenses.  The Company’s continued operations will depend on its ability to raise additional capital through various potential sources until it achieves profitability. Management is actively pursuing financing or other strategic plans but can provide no assurances that such financing or other strategic plans will be available on acceptable terms, or at all.

These condensed consolidated financial statements have been prepared with the assumption that the Company will continue as a going concern and will be able to realize its assets and discharge its liabilities in the normal course of business and do not include any adjustments to reflect the possible future effects on the recover ability and classification of assets or the amounts and classification of liabilities that may result from the inability of the Company to continue as a going concern.

## NOTE 3 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 1. Principles of Consolidation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and include the accounts of Milestone Scientific and its wholly owned and majority owned subsidiaries, including, Wand Dental (wholly owned), Milestone Advanced Cosmetic (majority owned) and Milestone Medical (majority owned). Milestone Education was a variable interest entity of which Milestone Scientific is the primary beneficiary and is consolidated into Milestone Scientific's financial statements.  Milestone Scientific purchased the remaining 50% of Milestone Education in September 2018, increasing its ownership of Milestone Education to 100%. All significant, intra-entity transactions and balances have been eliminated in the consolidation.

### 2.  Basis of Presentation

The unaudited condensed consolidated financial statements of Milestone Scientific have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information with the instructions for Form 10Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring entries) necessary to fairly present such interim results. Interim results are not necessarily indicative of the results of operations which may be expected for a full year or any subsequent period. These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2017, included in Milestone Scientific's Annual Report on Form 10-K.

### 3.  Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the condensed consolidated 2018 financial statement presentation. These reclassifications had no effect on net loss or cash flows as previously reported.

**4. Revenue Recognition**

Under ASC 606, the Company recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the Company expects to receive in exchange for those goods or services. To perform revenue recognition for arrangements within the scope of ASC 606, the Company performs the following five steps:

i. identification of the promised goods or services in the contract;
ii. determination of whether the promised goods or services are performance obligations including whether they are distinct in the context of the contract;
iii. measurement of the transaction price, including the constraint on variable consideration;
iv. allocation of the transaction price to the performance obligations based on estimated selling prices; and
v. recognition of revenue when (or as) the Company satisfies each performance obligation. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in ASC 606

The Company derives its revenues from the sale of its products, primarily dental instruments, handpieces, and other related products. The Company sells its products through a global distribution network and that includes both exclusive and non-exclusive distribution agreements with related and third parties.

Revenue from product sales is recognized upon transfer of control of a product to a customer, generally upon date of shipment. For certain arrangements where the shipping terms are FOB destination, revenue is recognized upon delivery. The Company has no obligation on product sales for any installation, set-up or maintenance, these being the responsibility of the buyer. Milestone Scientific's only obligation after sale is the normal commercial warranty against manufacturing defects if the alleged defective unit is returned within the warranty period.

**Sales Returns**

We generally do not accept non-defective returns from our customers. Product returns under warranty are accepted, evaluated and repaired or replaced in accordance with the Company’s warranty policy. Returns not within the warranty policy are evaluated and the customer is charged for repair.

**Financing and Payment**

Our payment terms differ by geography and customer, but payment is generally required within 90 days from the date of shipment or delivery.

**Disaggregation of Revenue**

We operate in two operating segments: dental and medical. Therefore, results of our operations are reported on a consolidated basis for purposes of segment reporting, consistent with internal management reporting. See Note 12 for revenues by geographical market, based on the customer’s location, and product category for the three and nine months ended September 30, 2018 and 2017.

**5.Variable Interest Entities**

A variable interest entity ("VIE") is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE.

If Milestone Scientific determines that it has operating power and the obligation to absorb losses or receive benefits, Milestone Scientific consolidates the VIE as the primary beneficiary. Milestone Scientific’s involvement constitutes power that is most significant to the entity when it has unconstrained decision-making ability over key operational functions within the entity.

Because Milestone Scientific has a variable interest in Milestone China, it considered the guidance in ASC 810, “Consolidation” as it relates to determining whether Milestone China is a VIE and, if so, identifying the primary beneficiary. As Milestone Scientific’s equity at risk and voting rights were not proportional to their economic interest in Milestone China, Milestone China was determined to be a VIE. Milestone Scientific would be considered the primary beneficiary of the VIE if it has both of the following characteristics:

Power Criterion: The power to direct the activities that most significantly impact the entity’s economic performance; and

Losses/Benefits Criterion: The obligation to absorb losses that could potentially be significant or the right to receive benefits that could potentially be significant to the VIE

Milestone Scientific does not have the ability to control the activities that most significantly impact Milestone China's economics and, therefore, the power criterion has not been met. Management placed the most weight on the relationship and significance of activities of Milestone China to the CEO and a group of significant shareholders of Milestone China which have the power to direct the activities that most significantly impact the economic performance of Milestone China. Management has concluded that Milestone Scientific is not the primary beneficiary under ASC 810. Accordingly, Milestone China has not been consolidated into the financial statements of Milestone Scientific and continues to be accounted for under the equity method. See Note 8.

**6. Cash and Cash Equivalents**

Milestone Scientific considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

**7. Accounts Receivable**

Milestone Scientific sells a significant amount of its product on credit terms to its major distributors. Milestone Scientific estimates losses from the inability of its customers to make payments on amounts billed. Most credit sales are due within 90 days from invoicing. There have not been any significant credit losses incurred to date. As of September 30, 2018, and December 31, 2017, accounts receivable was recorded, net of allowance for doubtful accounts of $10,000.

**8. Inventories**

Inventories principally consist of finished goods and component parts stated at the lower of cost (first-in, first-out method) or net realizable value. Inventory quantities on hand are reviewed on a quarterly basis and a provision for excess, slow moving, and obsolete inventory is recorded based on past and expected future sales, potential technological obsolescence and product expiration requirements.

**9. Equity Method Investments**

Investments in which Milestone Scientific can exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in the noncurrent assets on the Condensed Consolidated Balance Sheets. Under this method of accounting, Milestone Scientific's share of the net earnings or losses of the investee is presented below the income tax line on the Condensed Consolidated Statements of Operations. Milestone Scientific evaluates its equity method investments whenever events or changes in circumstance indicate that the carrying amounts of such investments may be impaired. If a decline in the value of an equity method investment is determined to be other than temporary, a loss is recorded in earnings in the current period.

**10. Intangible Assets – Patents and Developed Technology**

Patents are recorded at cost to prepare and file the applicable documents with the U.S. Patent and Trademark Office, or internationally with the applicable governmental office in the respective country. The costs related to these patents are being amortized using the straight-line method over the estimated useful life of the patent. Patents and other developed technology acquired from another business entity will be amortized at the estimated average useful life of the patent. These patents and developed technology are recorded at the acquisition cost. See Note 9.

Patent defense costs, to the extent applicable, are expensed as incurred.  Patent applications filed, and patents obtained in foreign countries are subject to the laws and procedures that differ from those in the United States. Patent protection in foreign countries may be different from patent protection under United States laws and may not be favorable to Milestone Scientific. Milestone Scientific also attempts to protect the proprietary information using confidentiality agreements and by limiting access to its facilities. There can be no assurance that the program of patents, confidentiality agreements and restricted access to the facilities will be sufficient to protect the proprietary technology.

**11. Impairment of Long-Lived Assets**

As of September 30, 2018, Milestone Scientific has reviewed long-lived assets for any impairments. The carrying value of the assets is evaluated in relation to the operating performance and future undiscounted cash flows of the underlying assets when an impairment indicator or triggering event occurs. Milestone Scientific adjusts the net book value of an underlying asset if its fair value is determined to be less than its net book value. At September 30, 2018, Milestone Scientific identified that the APAD Patents purchased in 2017, will not be further developed (due to lack of financial resources) for commercial launch before their estimated useful life expires and have therefore been impaired. The amount of the charge for the three and nine months ended September 30, 2018 was approximately $1,500,000. There were no impairment charges recorded during the three and nine months ended September 30, 2017.

**12. Research and Development**

Research and development costs, which consist principally of new product development costs payable to third parties, are expensed as incurred. Advance payments for the research are amortized to expense either as services are performed or over the relevant service period using the straight-line method.

**13. Income Taxes**

Milestone Scientific accounts for income taxes pursuant to the asset and liability method which requires deferred income tax assets and liabilities to be computed for temporary differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

**14. Basic and diluted net loss per common share**

Milestone Scientific presents “basic” earnings (loss) per common share applicable to common stockholders and, if applicable, “diluted” earnings (loss) per common share applicable to common stockholders pursuant to the provisions of ASC 260, “Earnings per Share”. Basic earnings (loss) per common share is calculated by dividing net income or loss applicable to common stockholders by the weighted average number of common shares outstanding and to be issued during each period. The calculation of diluted earnings per common share is like that of basic earnings per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, such as those issuable upon the exercise of stock options, warrants, and the conversion of debt were issued during the period.

Since Milestone Scientific had net losses for 2018 and 2017, the assumed effects of the exercise of potentially dilutive outstanding stock options and warrants were not included in the calculation as their effect would have been anti-dilutive. Such outstanding options and warrants totaled 3,518,668 and 3,710,335 at September 30, 2018 and December 31, 2017, respectively.

**15. Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to the allowance for doubtful accounts, inventory valuation, and cash flow assumptions regarding evaluations for impairment of long-lived assets and going concern considerations, and valuation allowances on deferred tax assets. Actual results could differ from those estimates**.**

**16. Stock-Based Compensation**

Milestone Scientific accounts for stock-based compensation under ASC 718, “Compensation – Stock Compensation”. ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized as expense over the requisite service period as an operating expense, based on the grant-date fair values.

The fair value of the employee and non-employee options was estimated on the date of grant using the Black Scholes option-pricing model. For the three months ended September 30, 2018 and 2017, Milestone Scientific recognized approximately $72,500 and $300,000 of expense related to employee options, respectively. For the nine months ended September 30, 2018 and 2017, Milestone Scientific recognized approximately $236,000 and $543,000 of expense related to employee options, respectively. For the three months ended September 30, 2018 and 2017, Milestone Scientific recognized approximately $4,000 of expense and $6,000 of income related to non-employee options, respectively. For the nine months ended September 30, 2018 and 2017, Milestone Scientific recognized approximately $11,000 of expense and $12,000 of income related to non-employee options, respectively

**17. Recent Accounting Pronouncements**

In February 2016, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)”. This ASU requires lessees to recognize a right of use asset and lease liability on the balance sheet for all leases with a term longer than 12 months, Under Topic 842, a modified retrospective transition approach is required, and the new standard is applied to all leases existing at the date of initial application. An entity may choose to use either (1) its effective date or (2) the beginning of the earliest comparative period presented in the financial statements as its date of initial application. We expect to adopt the new standard on January 1, 2019 and use the effective date as our date of initial application. Consequently, prior period financial information will not be updated, and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019. We are currently evaluating the impact of adopting this guidance on our consolidated balance sheets, results of operations and financial condition.

In February 2018, the FASB issued ASU No. 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220)”, which amends the previous guidance to allow for certain tax effects “stranded” in accumulated other comprehensive income, which are impacted by the Tax Cuts and Jobs Act (the “Act”), to be reclassified from accumulated other comprehensive income into retained earnings. This amendment pertains only to those items impacted by the new tax law and will not apply to any future tax effects stranded in accumulated other comprehensive income. This standard is effective for fiscal years beginning after December 15, 2018 and allows for early adoption. The Company does not anticipate that the adoption of this standard will have a material impact on the Company’s consolidated balance sheet.

In June 2018, the FASB issued ASU 2018-07 to simplify the accounting for share-based payments to non-employees by aligning it with the accounting for share-based payments to employees, with certain exceptions. The new guidance expands the scope of

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Accounting Standards Codification, or ASC, 718 to include share-based payments granted to non-employees in exchange for goods or services used or consumed in an entity's own operations and supersedes the guidance in ASC 505-50. The guidance is effective for public business entities in annual periods beginning after December 15, 2018, and interim periods within those annual periods. Early adoption is permitted, including in an interim period for which financial statements have not been issued, but not before an entity adopts ASC 606. The Company adopted this standard during the quarter ended September 30, 2018 and there was no material impact on the Company's condensed consolidated financial statements.

**NOTE 4 — NOTES RECEIVABLE, RELATED PARTY**

In June 2017, Milestone Scientific entered into an agreement for the sale of its forty percent (40%) interest in Milestone China (the "Milestone China Shares") to an unaffiliated United States domiciled purchaser and a 10-year option agreement to repurchase the Milestone China Shares. The purchase price for the Milestone China Shares was $1,400,000 of which $125,000 was paid in cash and $1,275,000 was paid by delivery of a non-interest bearing secured promissory note. The note was payable in quarterly installments of $125,000 and was secured by the Milestone China Shares until full repayment. In addition, the purchaser was precluded from selling all or substantially all its assets prior to repayment of the note. The 10-year option agreement provides Milestone Scientific an option to repurchase the Milestone China Shares at $1,400,000 within the first two years and at fair market value (as defined in such agreement) for the remainder of the 10-year term.

The transaction was accounted for as a secured financing and Milestone Scientific continued to account for its relationship with Milestone China under the equity method of accounting. A note receivable was presented on the Company's condensed consolidated balance sheet along with a deferred gain from financing transaction of $1,400,000. The carrying value of the forty (40%) percent investment in Milestone China at the transaction date was zero.

As of March 2, 2018, the promissory note was in default. In April 2018, Milestone Scientific entered into a Release, Assignment and Termination Agreement (the "Termination Agreement") with the issuer of the promissory note, pursuant to which, Milestone Scientific repaid the $250,000 payment made by the issuer and the issuer returned the shares of Milestone China's common stock to Milestone Scientific and cancelled the promissory note. Because of the Termination Agreement and related repayment made by Milestone Scientific, the Company derecognized the outstanding note receivable balance of $1,150,000 and the related deferred gain from financing transaction of $1,400,000. No gain or loss was recognized on the transaction.

**NOTE 5 — INVENTORIES**

Inventories at September 30, 2018 and December 31, 2017 consist of the following:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Dental finished goods, net | $1,855,538 | $2,846,272 |
| Medical finished goods, net | 209,329 | 475,285 |
| Component parts and other materials | 181,091 | 57,652 |
| Total inventories | $2,245,958 | $3,379,209 |

As of September 30, 2018, and December 31, 2017, inventory was recorded net of allowance for slow moving and damaged inventory of approximately $783,000 and $220,000, respectively.

**NOTE 6 — ADVANCES ON CONTRACTS**

The advances on contracts represent funding of future STA inventory purchases and Epidural replacements parts. The balance of the advances as of September 30, 2018 and December 31, 2017 was $884,823 and $697,192 respectively. The advance are classified as current based on the estimated annual usage of the underlying inventory.

**NOTE 7 – CONSOLIDATION OF VARIABLE INTEREST ENTITY**

Milestone Education was, until September 2018 (see below), a 50% owned subsidiary of Milestone Scientific which began operations in 2013 to provide training and education to dentists throughout the world. As of September 30, 2018, and 2017, approximately 80% and 81%, respectively, of the revenue earned by Milestone Education is from services performed for Milestone Scientific. Because of this dependency and relationship, we determined that Milestone Scientific had the power to direct the activities that most significantly impact Milestone Education's economic performance, and therefore Milestone Education is consolidated in our financial statements. Milestone Scientific purchased the remaining 50% of Milestone Education in September 2018 for a nominal purchase price. Milestone Scientific acquired the non-controlling interest in the amount of $8,020.

**NOTE 8 – INVESTMENT IN UNCONSOLIDATED AFFILIATE**

**Milestone China Ltd.**

In June 2014, Milestone Scientific invested $1 million in Milestone China Ltd. (“Milestone China”) by contributing 772 STA Instruments to Milestone China for a 40% ownership interest. Milestone Scientific recorded this investment under the equity method of accounting. As of September 30, 2018, and December 31, 2017, Milestone Scientific's investment in Milestone China was $0. As of September 30, 2018, and December 31, 2017, Milestone Scientific’s share of cumulative losses of Milestone China were $3,881,726 and $3,147,470, respectively, which have been suspended.

Due to timing differences of when the inventory sold to Milestone China is recognized and when Milestone China sells the acquired inventory to third parties, an elimination of the intra-entity profit is required as of the balance sheet date. In accordance with ASC 323, “Investments – Equity Method and Joint Ventures”, Milestone Scientific has deferred 40% of the gross profit associated with recognized revenue from Milestone China that has not been sold to third parties by Milestone China. At September 30, 2018 and December 31, 2017, deferred profit was $492,884 and $751,500, respectively, which is included in deferred profit, related party in the condensed consolidated balance sheets. Milestone Scientific recorded earnings and loss on its investment in Milestone China of $143,242 and $258,616 for the three and nine months ended September 30, 2018, respectively, and $0 and ($28,941) for the three and nine months ended September 30, 2017, respectively, inclusive of the change in intra-entity deferral of profit.

Milestone Scientific defers the total revenue and costs of goods sold when devices and handpieces are shipped to Milestone China and Milestone China’s agents due to market conditions and Milestone China liquidity concerns, until a payment is received. As of September 30, 2018, Milestone Scientific had deferred revenues and deferred costs associated with sales to Milestone China and its agents was approximately $1.3 million and $790,000, respectively. As of December 31, 2017, Milestone Scientific had deferred revenues and deferred costs associated with sales to Milestone China and its agents was approximately $1.7 million and $1.1 million, respectively. Milestone Scientific recognized $300,000 related party revenue from Milestone China and it’s agents during the three and nine months ended September 30, 2018. Milestone Scientific recognized $356,400 and $1.7 million of related party revenue for the three and nine months ended September 30, 2017. See Note 14 for  related party transactions.

As of  September  30, 2018,  Milestone China missed its schedule payment of $200,000 in accordance with the previously agreed upon payment terms with Milestone Scientific Inc. which requires $200,000 per month through November 2018 and a balloon payment of approximately $1,425,000 during December 2018.   Due to the delinquent nature of the scheduled payments and Milestone China’s further liquidity constraints, Milestone Scientific reduced accounts receivable, related party and deferred revenue, related party by $1,258,995. Additionally, Milestone Scientific recorded a reserve of $790,189 against the associated deferred cost, related party. These reserves will be reviewed periodically and adjusted based on updated fact and circumstances.

The following table includes summarized financial information (unaudited) of Milestone China:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Assets: | | |
| Current assets | $13,972,657 | $13,127,422 |
| Non-current assets | 2,920,936 | 3,213,520 |
| Total assets: | $16,893,593 | $16,340,942 |
| | | |
| Liabilities: | | |
| Current liabilities | 21,122,545 | 18,468,937 |
| Stockholders' equity | (4,228,952 ) | (2,127,995 ) |
| Total liabilities and stockholders' equity | $16,893,593 | $16,340,942 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net sales | $1,710,473 | $1,382,588 | $3,795,507 | $2,548,140 |
| Cost of goods sold | 789,957 | 556,430 | 1,888,409 | 1,445,634 |
| Gross Profit | 920,516 | 826,158 | 1,907,098 | 1,102,506 |
| Other Expenses | (1,371,085) | (1,886,180) | (3,742,737) | (3,487,845) |
| Net Losses | $(450,569) | $(1,060,022) | $(1,835,639) | $(2,385,339) |

**NOTE 9 — INTANGIBLE ASSETS, PATENTS**

Patents at September 30, 2018 and December 31, 2017 are comprised of the following:

| | September 30, 2018 | | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Cost | Impairment | Accumulated Amortization | Net | Cost | Impairment | Accumulated Amortization | Net |
| Patents-foundation intellectual property | $1,377,863 | $- | $(929,335) | $448,528 | $1,377,863 | $- | $(787,821) | $590,042 |
| Epidural-Apad acquired patents | 2,639,647 | (1,539,794) | (1,099,853) | - | 2,639,647 | - | (439,941) | 2,199,706 |
| Total | $4,017,510 | $(1,539,794) | $(2,029,188) | $448,528 | $4,017,510 | $- | $(1,227,762) | $2,789,748 |

Patents are amortized utilizing the straight-line method over estimated useful lives ranging from 3 to 20 years. At September 30, 2018, Milestone Scientific identified that the APAD Patents purchased in 2017, will not be developed (due to lack of financial resources) into marketable instruments in the near term. As such, Management has determined that these patents meet the accounting requirements for impairment. The impairment charge for the three and nine months ended September 30, 2018 was $1,539,794. Amortization expense was $332,071 and $151,845 for the three months ended September 30, 2018 and 2017, respectively. Amortization expense was $801,426 and $187,209 for the nine months ended September 30, 2018 and 2017, respectively.

**NOTE 10 — STOCKHOLDERS' EQUITY**

**Shares to be Issued**

As of September 30, 2018, and December 31, 2017, there were 1,909,175 and 1,401,247 shares of common stock, respectively, whose issuance has been deferred under the terms of an employment agreements with the Interim Chief Executive Officer, Chief Financial Officer and other employees of Milestone Scientific. Such shares will be issued to each such person upon termination of their employment. The number of shares was fixed at the date of grant and were fully vested upon grant date.

**Shares Reserved for Future Issuance**

As of September 30, 2018, and December 31, 2017 there were 5,300,854 and 5,111,582 shares reserved for future issuance and 3,518,668, and 3,710,335 shares underlying other stock options and warrants outstanding, respectively. At September 30, 2018 and December 31, 2017, there were 1,909,175 shares and 1,401,247 shares, respectively, reserved for issuance in settlement of deferred compensation to officers of Milestone Scientific.

**NOTE 11 — INCOME TAXES**

Due to Milestone Scientific's history of operating losses, a full valuation allowances have been provided for all of Milestone Scientific's deferred tax assets. As of September 30, 2018, and December 31, 2017, no recognition was given to the utilization of the remaining net operating loss carry-forwards in each of these periods.

The utilization of Milestone Scientific's net operating losses may be subject to a substantial limitation due to the "change of ownership provisions" under Section 382 of the Internal Revenue Code and similar state provisions. Such limitation may result in the expiration of the net operating loss carry forwards before their utilization. Milestone Scientific has established a 100% valuation allowance for all its deferred tax assets due to uncertainty as to their future realization.

Accounting for uncertainties in income taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, disclosure and transition. At September 30, 2018, and December 31, 2017, we had no uncertain tax positions that required recognition in the consolidated financial statements Tax returns for the 2014, 2015, 2016 and 2017 years are subject to audit by federal and state jurisdictions.

**NOTE 12 — SEGMENT AND GEOGRAPHIC DATA**

We conduct our business through two reportable segments dental and medical.  These segments offer different products to different customer base.

The following tables present information about our reportable and operating segments:

| **Sales** | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| **Net Sales:** | **2018** | **2017** | **2018** | **2017** |
| Dental | $1,622,246 | $2,853,813 | $5,780,251 | $9,066,550 |
| Medical | - | - | 76,100 | - |
| Total net sales | $1,622,246 | $2,853,813 | $5,856,351 | $9,066,550 |
| | | | | |
| **Operating Income (Loss):** | **2018** | **2017** | **2018** | **2017** |
| Dental | $(893,148) | $711,589 | $119,613 | $2,547,599 |
| Medical | (454,306) | (517,938) | (2,008,852) | (1,746,391) |
| Corporate | (3,200,126) | (1,607,258) | (6,084,685) | (4,293,125) |
| Total operating Income (loss) | $(4,547,580) | $(1,413,607) | $(7,973,924) | $(3,491,917) |
| | | | | |
| **Depreciation and Amortization:** | **2018** | **2017** | **2018** | **2017** |
| Dental | $3,889 | $4,261 | $12,133 | $13,187 |
| Medical | 2,530 | 5,515 | 21,884 | 21,436 |
| Corporate | 338,565 | 155,092 | 821,084 | 196,632 |
| Total depreciation and amortization | $344,984 | $164,868 | $855,101 | $231,255 |
| | | | | |
| **Income (loss) before taxes and equity in earnings of affiliates:** | **2018** | **2017** | **2018** | **2017** |
| Dental | $(959,095) | $714,840 | $125,734 | $2,553,437 |
| Medical | (454,906) | (518,398) | (2,010,595) | (1,747,791) |
| Corporate | (3,133,819) | (1,607,513) | (6,088,167) | (4,294,346) |
| | $(4,547,820) | $(1,411,071) | $(7,973,028) | $(3,488,700) |

Total income (loss) before taxes and equity in earnings of affiliate

| **Total Assets:** | **September 30,** | **December 31,** |
|---|---|---|
| | **2018** | **2017** |
| Dental | $6,380,314 | $10,255,144 |
| Medical | 384,849 | 655,513 |
| Corporate | 860,058 | 4,718,130 |
| Total assets | $7,625,221 | $15,628,787 |

The following table presents information about our operations by geographic area.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| **Domestic-US & Canada** | 2018 | 2017 | 2018 | 2017 |
| Devices | $119,190 | $452,232 | $251,743 | $857,525 |
| Handpieces | 369,027 | 893,496 | 2,296,533 | 3,230,567 |
| Other | 21,037 | 12,338 | 72,265 | 53,037 |
| **Total Domestic US & Canada** | $509,254 | $1,358,066 | $2,620,541 | $4,141,129 |
| **International ROW** | | | | |
| Devices | $299,872 | $340,575 | $952,390 | $1,053,050 |
| Handpieces | 506,880 | 765,821 | 1,924,901 | 2,068,007 |
| Other | 6,240 | 32,951 | 58,519 | 89,764 |
| **Total International-ROW** | $812,992 | $1,139,347 | $2,935,810 | $3,210,821 |
| **International-China** | | | | |
| Devices | $- | $- | $- | $1,000,000 |
| Handpieces | 300,000 | 356,400 | 300,000 | 712,800 |
| Other | - | - | - | 1,800 |
| **Total International** | $300,000 | $356,400 | $300,000 | $1,714,600 |
| **Domestic. International Analysis** | | | | |
| Domestic-US & Canada | $509,254 | $1,358,066 | $2,620,541 | $4,141,129 |
| International -ROW | 812,992 | 1,139,347 | 2,935,810 | 3,210,821 |
| International -China | 300,000 | 356,400 | 300,000 | 1,714,600 |
| **Total Product Sales** | $1,622,246 | $2,853,813 | $5,856,351 | $9,066,550 |

**NOTE 13 -- CONCENTRATION**

Milestone Scientific has informal arrangements with third-party manufacturers of the STA, *CompuDent*® and *CompuMed*® devices, pursuant to which they manufacture these products under specific purchase orders but without any long-

term contract or minimum purchase commitment. Consequently, advances on contracts have been classified as current at September 30, 2018 and December 31, 2017, respectively. The termination of the manufacturing relationship with any of these manufacturers could have a material adverse effect on Milestone Scientific’s ability to produce and sell its products. Although alternate sources of supply exist, and new manufacturing relationships could be established, Milestone Scientific would need to recover its existing tools or have new tools produced. Establishment of new manufacturing relationships could involve significant expense and delay. Any curtailment or interruption of the supply, because of termination of such a relationship, would have a material adverse effect on Milestone Scientific’s financial condition, business and results of operations.

For the three months ended September 30, 2018, an aggregate of approximately 35% of Milestone Scientific's net product sales were to one customer/distributor. For the nine months ended September 30, 2018, an aggregate of approximately 48% of Milestone Scientific's net product sales were to one customer/distributor. For the three months ended September 30, 2017 , an aggregate of approximately 67% of Milestone Scientific's net product sales were to two customers/ distributors (one of which, Milestone China, is a related party), 54%, and 13%, respectively. For the nine months ended September 30, 2017, an aggregate of approximately 72% of Milestone Scientific's net product sales were to two customers/distributors (one of which, Milestone China, is a related party), 53%, and 19%, respectively.

Accounts receivable, including related party accounts receivable for the major customer/distributors, (one of which, Milestone China, is a related party), amounted to approximately $1,695,967 (net of allowance for doubtful accounts) , or 55% and 19% of Milestone Scientific's accounts receivable as of September 30, 2018. Accounts receivable, including related party accounts receivable, for the major customer/distributors (one of which, Milestone China, is a related party), amounted to approximately $2,555,476, or 53% and 25% of Milestone Scientific's accounts receivable, as of December 31, 2017.

**NOTE 14 -- RELATED PARTY TRANSACTIONS**

**United Systems**

Milestone Scientific has a manufacturing agreement with United Systems (whose controlling shareholder, Tom Cheng, is a significant stockholder of Milestone Scientific), the principal manufacturers of its handpieces, pursuant to which it manufactures products under specific purchase orders, but without minimum purchase commitments. Purchases from this manufacturer were $361,727 and $900,000 for the three and nine months ended September 30, 2018, respectively. Purchases from this manufacturer were $721,225 and $1,690,582 for the three and nine months ended September 30, 2017, respectively. As of September 30, 2018, and December 31, 2017, Milestone Scientific owed this manufacturer $1,285,681 and $985,678, respectively, which is included in accounts payable, related party on the condensed consolidated balance sheet.

During the nine months ended September 30, 2018 Milestone Scientific through its wholly owned subsidiary, Wand Dental, entered into an agreement with United Systems. The agreement was a Royalty Agreement for handpieces sold to Milestone China by United Systems. United Systems will pay Wand Dental a royalty equal to the net profit that Wand Dental would have received if the handpieces were sold directly to Milestone China or its Agent. As of September 30, 2018, Wand Dental has deferred royalty income of $342,540 that will be recognized at the earlier of when payment of the royalties is received from United Systems or when collectability is deemed to be assured and is included in accounts receivable, related party and deferred revenue, related party on the condensed consolidated balance sheet.

Also, during the nine months ended September 30, 2018, a Distribution agreement between Wand Dental and United Systems was formed. Under the Distribution agreement United Systems purchased 1,000 STA instruments in June 2018, for delivery to Milestone China. Due to the related party nature and collectability concerns Wand Dental has deferred the sale. Milestone Scientific has deferred approximately $750,000 of related party sales of devices to Milestone China under the agreement with United Systems as of September 30, 2018. As of September 30, 2018, Milestone Scientific recorded accounts receivable, related party and deferred revenue, related party of $750,000 and deferred cost, related of $686,365, respectively. The deferred revenue, accounts receivable and deferred cost from this transaction are included in accounts receivable, deferred revenue and deferred cost related party related to Milestone China disclosed below.

**Milestone China**

As of March 2, 2018, the promissory note (See note 4) was in default. In April 2018, Milestone Scientific entered into a Release, Assignment and Termination Agreement (the "Termination Agreement") with the issuer of the promissory note, pursuant to which, Milestone Scientific repaid the $250,000 payment made by the issuer and the issuer returned the shares of Milestone China's common stock to Milestone Scientific and cancelled the promissory note.

Milestone Scientific defers the total revenue and costs of goods sold when devices and handpieces are shipped to Milestone China and Milestone China's agents due to market conditions and Milestone China liquidity concerns, until a payment is received. As of September 30, 2018, Milestone Scientific had deferred revenues and deferred costs associated with sales to Milestone China and its agents was approximately $1.3 million and $790,000, respectively. As of December 31, 2017, Milestone Scientific had deferred revenues and deferred costs associated with sales to Milestone China and its agents was approximately $1.7 million and $1.1 million, respectively. Milestone Scientific recognized $300,000 related party revenue from Milestone China and it's agents during the three and nine months ended September 30, 2018. Milestone Scientific recognized $356,400 and $1.7 million of related party revenue for the three and nine months ended September 30, 2017. See Note 8 for further information.

**Other**

In August 2016, K. Tucker Andersen, a significant stockholder of Milestone Scientific, entered into a three-year agreement with Milestone Scientific to provide financial and business strategic services. Expenses recognized on this agreement were $25,000 and $75,000 for the three and nine months ended September 30, 2018 and 2017, respectively.

In January 2017, Milestone Scientific entered into a twelve-month agreement with Innovest S.p.A., a significant stockholder of Milestone Scientific, to provide consulting services. This agreement will renew for successive twelve-month terms unless terminated by Innovest S.p.A or Milestone Scientific. Expenses recognized on this agreement were $20,000 and $60,000 for the three and nine months ended September 30, 2018 and 2017, respectively.

**NOTE 15 — COMMITMENTS**

**(1) Contract Manufacturing Agreement**

Milestone Scientific has informal arrangements with third-party manufacturers of the STA, CompuDent® and CompuMed® devices, pursuant to which they manufacture these products under specific purchase orders but without any long-term contract or minimum purchase commitment. In January 2018, Wand Dental entered into a new purchase commitment for the delivery of 2,000 devices beginning in the third quarter of 2018, Milestone Scientific's purchase commitment for this purchase order was $1,152,888 at September 30, 2018, however an advance of $884,823 was recorded against this purchase order at September 30, 2018 Milestone Scientific still owes $268,065 related to this purchase order. An advance of $884,823 and $697,192 was recorded at September 30, 2018 and December 31, 2017, respectively.

**(2) Other Commitments**

In February 2018, Milestone Scientific and Daniel Goldberger, the Company's former President and Chief Executive Officer, who resigned effective October 2, 2017, signed a Settlement and Release Agreement with respect to Mr. Goldberger's leaving the Company. The gross settlement was $175,000, of which $147,222 was paid through September 2018. The remainder of the settlement will be paid over the next two-month period ending in November 2018.

The technology underlying the Safety Wand® and *CompuFlo*®, and an improvement to the controls for *CompuDent*® were developed by the Director of Clinical Affairs and assigned to Milestone Scientific. Milestone Scientific purchased this technology pursuant to an agreement dated January 1, 2005. The Director of Clinical Affairs will receive additional payments of 2.5% of the total sales of products using certain of these technologies, and 5% of the total sales of products using certain other of the technologies until the expiration of the last patent covering these technologies. If products produced by third parties use any of these technologies (under license from us) then the Director of Clinical Affairs will receive the corresponding percentage of the consideration received by Milestone Scientific for such sale or license.

The Director of Clinical Affairs' royalty fee was $77,907 and $284,437 for three and nine months ended September 30, 2018, respectively. The Director of Clinical Affairs' royalty fee was $122,606 and $446,098 for three and nine months ended September 30, 2017, respectively. Additionally, Milestone Scientific expensed consulting fees to the Director of Clinical Affairs of $39,000 and $146,751 for three and nine months ended September 30, 2018, respectively, and $68,751 and $206,253 for three and nine months ended September 30, 2017, respectively. As of September 30, 2018, and December 31, 2017 Milestone Scientific owes the Director Clinical Affairs for royalties of approximately $232,000 and $108,000, respectively, which is included in accounts payable, related party and accrued expense, related party.

In May 2018, the Company entered a twelve-month Consulting Agreement to provide corporate finance advice, assisting the Company to establish corporate financing goals, and creating public awareness in European markets. The Company shall grant to the Consultant, upon fulfillment of the Condition Precedent (as set forth below), an option to buy from the Company 500,000 shares of newly issued common stock at the price of $1.00; such option being exercisable any time up to the first anniversary year of the Consulting Agreement.

The Condition Precedent is the purchase by the Consultant of at least 400,000 shares of the Company's common stock from the secondary market within 30 days of signing the Consulting Agreement. If the Consultant purchases up to additional 400,000 shares of the Company's common stock in the secondary market in the period between 30 to 60 days from the date of the Consulting Agreement, the option will increase up to an additional 500,000 shares of newly issued common stock at a price of $1.00 per share, the proportion shall be on a 4 to 5 ratio (e.g., 400,000 shares purchased equals 500,000 shares option). This Consulting Agreement was terminated in July 2018, on basis that the consultant did not fulfill the condition precedent.

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussions of the financial condition and results of operations should be read in conjunction with the financial statements and the notes to those statements included elsewhere in this annual report. Certain statements in this discussion and elsewhere in this report constitute forward-looking statements, within the meaning of section 21E of the Exchange Act, that involve risks and uncertainties. The actual results may differ materially from those anticipated in these forward-looking statements.

**OVERVIEW**

Milestone Scientific is a biomedical technology research and development company that patents, designs, develops and commercializes innovative diagnostic and therapeutic injection technologies and devices for medical, dental, cosmetic and veterinary applications. Since our inception, we have engaged in pioneering proprietary, innovative, computer-controlled injection technologies and solutions for the medical and dental markets. We have focused our resources on redefining the worldwide standard of care for injection techniques by making the experience more comfortable for the patient by reducing the anxiety and stress of receiving injections from the healthcare provider. Our computer-controlled injection systems make injections precise, efficient and virtually painless. Milestone's proprietary *DPS* Dynamic Pressure Sensing technology is our technology platform that advances the development of next-generation devices, regulating flow rate and monitoring pressure from the tip of the needle, through platform extensions for local anesthesia for subcutaneous drug delivery, with specific applications for cosmetic botulinum toxin injections, epidural space identification in regional anesthesia procedures and intra-articular joint injections.

Milestone Scientific remains focused on advancing efforts to achieve the following five primary objectives:

Establishing Milestone's DPS Dynamic Pressure Sensing technology platform as the standard-of-care in painless and precise drug delivery, providing for the first-time objective visual and audible in-tissue pressure feedback, and continuing to expand platform applications;
Following successful FDA clearance of our first medical device in June 2017, Milestone Scientific is transitioning from a research and development organization to a commercially focused medical device company;
Commercializing our *CompuFlo* Epidural System, a transformative device for epidural anesthesia procedures;
Expanding the global footprint of our CompuFlo Epidural System by partnering with distribution companies worldwide; and
Obtaining regulatory approval of our proprietary cosmetic injection device for delivery of botulinum toxin (such as Botox® and Dysport®) and subsequent commercial launch.

**Distribution and Marketing Arrangements**

Our dental devices are sold in the United States, Canada, and in 53 other countries. In June 2017, we received FDA regulatory clearance to sell our first medical device, the *CompuFlo* Epidural System in the United States. Since receiving FDA clearance in 2017 our epidural devices have had minimal sales in the United States and Europe.

**Dental Market**

In the spring of 2009, Milestone Scientific signed a distribution and marketing agreement with China National Medicines Corporation, dba Sinopharm. In early October 2012, the State Food and Drug Administration ("CFDA") of the People's Republic of China approved the *Wand STA* System. However, the CFDA's approval of the Wand STA handpieces was not received until May 2014 and the distribution of these handpieces in China began in the fourth quarter of 2014. The distribution and marketing agreement with Sinopharm were terminated in September 2014. Proximate to that time, we entered into a new agreement with Milestone China to be our distributor for the *Wand STA* System and handpieces in China.

In November 2012, Milestone Scientific signed an exclusive distributor and marketing agreement with a well-known U.S. domestic manufacturer and distributor, for the sale and distribution of the *Wand STA* System and handpieces in the United States and Canada. The marketing initiative included participation in United States and Canadian dental shows, as well as pediatric dental shows; an active advertising initiative targeting major dental publications; and direct mailing campaigns to over 150,000 dentists across the United States and Canada. This exclusive distributor and marketing agreement was converted to a non-exclusive agreement as of December 31, 2016.

Beginning January 1, 2016, Milestone Scientific entered into a non-exclusive distribution agreement with Henry Schein. In June 2016, that agreement was replaced by a new agreement with Henry Schein providing for an exclusive distribution arrangement for our dental products in the United States and Canada by a newly formed marketing and sales group at Henry Schein. Under this arrangement, we have a semi-dedicated independent sales force visiting dentists. Henry Schein's exclusive products sales specialist team, which is comprised of 25 sales representatives and supported by over 1,000 field service representatives, will exclusively market and distribute the *Wand STA* System and handpieces, together with a select group of other devices in the United States and Canada. Our agreement with Henry Schein has minimum purchase orders to maintain exclusivity in the third through tenth years. We believe that this exclusive arrangement will be more effective than previous arrangements relying on Wand Dental's appearances at dental shows and catalog sales.

**Medical Market**

Having received FDA clearance to sell the *CompuFlo* Epidural System in June 2017, we are in discussions with, and have entered into a small number of agreements with, regional and national distributors. Our immediate focus is on marketing our epidural device in the U.S. and throughout Europe.

In February and March 2018, Milestone Scientific hired an Executive VP of Global Sales and Marketing and a Vice President of US Sales to fill a significant gap in our commercialization efforts of the *CompuFlo* Epidural System.

In October 2018, Milestone Scientific signed its first USA Stocking Distributor Agreement for the CompuFlo Epidural device. This distributor purchases devices and disposables subsequent to signing the agreement.

We have entered into a limited number of distributor arrangements in Europe and the Middle East for our CompuFlo Epidural Computer Controlled Anesthesia System. Our distribution strategy is initially aimed at having Key Opinion Leaders (KOL) use and accept the device and initiate their own studies. This having been accomplished we are now placing devices in key institutions.

The following table shows a breakdown of Milestone Scientific's product sales (net), domestically and internationally, by business segment product category for three months ended September 30, 2018 and 2017:

| | Three months ended September 30, 2018 | | | Three months ended September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Dental | Medical | Total | Dental | Medical | Total |
| Domestic US / Canada: | | | | | | |
| Device | $119,190 | $ - | $119,190 | $452,232 | $ - | $452,232 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Handpieces | 369,027 | | - | 369,027 | 893,496 | | - | 893,496 |
| Other | 21,037 | | - | 21,037 | 12,338 | | - | 12,338 |
| Total Domestic US / Canada | $509,254 | $ | - | $509,254 | $1,358,066 | $ | - | $1,358,066 |
| | | | | | | | | |
| International Rest of the World: | | | | | | | | |
| Device | $299,872 | $ | - | $299,872 | $340,575 | $ | - | $340,575 |
| Handpieces | 506,880 | | - | 506,880 | 765,821 | | - | 765,821 |
| Other | 6,240 | | - | 6,240 | 32,951 | | - | 32,951 |
| Total International Rest of the World | $812,992 | $ | - | $812,992 | $1,139,347 | $ | - | $1,139,347 |
| | | | | | | | | |
| International China: | | | | | | | | |
| Device | $- | $ | - | $- | $- | $ | - | $- |
| Handpieces | 300,000 | | - | 300,000 | 356,400 | | - | 356,400 |
| Other | - | | - | - | - | | - | - |
| Total International China | $300,000 | $ | - | $300,000 | $356,400 | $ | - | $356,400 |
| Total Product Sales | $1,622,246 | $ | - | $1,622,246 | $2,853,813 | $ | - | $2,853,813 |

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The following table shows a breakdown of Milestone Scientific's product sales (net), domestically and internationally, by business segment product category for the nine months ended September 30, 2018 and 2017:

| | Nine months ended September 30, 2018 | | | Nine months ended September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Dental | Medical | Total | Dental | Medical | Total |
| Domestic US / Canada: | | | | | | |
| Device | $251,743 | $- | $251,743 | $857,525 | $ - | $857,525 |
| Handpieces | 2,296,533 | - | 2,296,533 | 3,230,567 | - | 3,230,567 |
| Other | 72,265 | - | 72,265 | 53,037 | - | 53,037 |
| Total Domestic US / Canada | $2,620,541 | $- | $2,620,541 | $4,141,129 | $ - | $4,141,129 |
| International Rest of the World: | | | | | | |
| Device | $876,290 | $70,500 | $946,790 | $1,053,050 | $ - | 1,053,050 |
| Handpieces | 1,924,901 | 5,600 | 1,930,501 | 2,068,007 | - | 2,068,007 |
| Other | 58,519 | - | 58,519 | 89,764 | - | 89,764 |
| Total International Rest of the World | $2,859,710 | $76,100 | $2,935,810 | $3,210,821 | $ - | $3,210,821 |
| International China: | | | | | | |
| Device | $- | $- | $- | $1,000,000 | $ - | $1,000,000 |
| Handpieces | 300,000 | - | 300,000 | 712,800 | - | 712,800 |
| Other | - | - | - | 1,800 | - | 1,800 |
| Total International China | $300,000 | $- | $300,000 | $1,714,600 | $ - | $1,714,600 |
| Total Product Sales | $5,780,251 | $76,100 | $5,856,351 | $9,066,550 | $ - | $9,066,550 |

Milestone Scientific plans to support increased sales and marketing activity through our current distributors and through newly appointed distributors of the Wand STA devices and handpieces in the international market. In the United States and Canada, Milestone Scientific will continue the utilization of independent hygienists for training individual practitioners and group practices domestically, refined and directed advertising to dental professionals, continue to develop Key Opinion Leaders (KOL) and support and broaden our global distribution network. Additionally, with the FDA marketing clearance for the *CompuFlo* Epidural System, Milestone Scientific is initiating marketing and sales efforts in the U.S. to establish medical sector distributors for the sale of this device.

**Current Product Platform**

See Item 1. Description of Business.

**Results of Operations**

The following table sets forth for the consolidated results of operations for the three months ended September 30, 2018 compared to 2017 as a percentage of revenues. The trends suggested by this table may not be indicative of future operating results:

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| Operating results: | | | | |
| Product sales, net | $1,622,246 | 100 % | $2,853,813 | 100 % |
| Cost of products sold | 1,742,451 | 107 % | 1,044,540 | 37 % |
| Gross profit (loss) | (120,205) | -7 % | 1,809,273 | 63 % |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 2,886,081 | 178 % | 3,205,996 | 112 % |
| Research and development expenses | 1,500 | 0 % | 16,884 | 1 % |
| Impairment of long lived assets | 1,539,794 | 95 % | - | 0 % |
| Loss from operations | (4,547,580) | -280 % | (1,413,607) | -50 % |
| Other income, net | 143,015 | 9 % | (3,939) | 0 % |
| Net loss | (4,404,565) | -272 % | (1,417,546) | -50 % |
| Net loss attributable to noncontrolling interests | 11,742 | 1 % | 6,605 | 0 % |
| Net loss attributable to Milestone Scientific Inc. | $(4,392,823) | -271 % | $(1,410,941) | -49 % |

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The following table sets forth for the consolidated results of operations for the nine months ended September 30, 2018 compared to 2017 as a percentage of product sales, net. The trends suggested by this table may not be indicative of future operating results:

| | Nine Months Ended September 30, 2018 | | 2017 | |
|---|---|---|---|---|
| Operating results: | | | | |
| Product sales, net | $5,856,351 | 100 % | $9,066,550 | 100 % |
| Cost of products sold | 3,326,341 | 57 % | 3,320,411 | 37 % |
| Gross profit | 2,530,010 | 43 % | 5,746,139 | 63 % |
| | | | | |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 8,748,485 | 149 % | 8,996,092 | 99 % |
| Research and development expenses | 215,655 | 4 % | 241,964 | 3 % |
| Impairment of long lived assets | 1,539,794 | 26 % | - | 0 % |
| Loss from operations | (7,973,924) | -136 % | (3,491,917) | -39 % |
| Other income, net | 243,987 | 4 % | (44,063) | 0 % |
| Net loss | (7,729,937) | -132 % | (3,535,980) | -39 % |
| Net loss attributable to noncontrolling interests | 118,424 | 2 % | 138,915 | 2 % |
| Net loss attributable to Milestone Scientific Inc. | $(7,611,513) | -130 % | $(3,397,065) | -37 % |

| Cash flow: | September 30, 2018 | September 30, 2017 |
|---|---|---|
| Net cash used in operating activities | $(1,957,602) | $(1,560,152) |
| Net cash used in investing activities | (14,525) | (197,916) |
| Net cash provided by financing activities | (250,000) | 463,366 |

**Three Months Ended September 30, 2018 compared to Three Months Ended September 30, 2017**

**Net sales for three months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $1,622,248 | $2,853,813 | $(1,231,565) | -43.16 % |
| Medical | - | - | - | - |
| Total sales, net | $1,622,248 | $2,853,813 | $(1,231,565) | -43.16 % |

Consolidated revenue for the three months ended September 30, 2018 and 2017 were approximately $1.6 million and $2.8 million, respectively. Dental revenue decreased approximately $1.2 million during the three months ended September 2018 compared to 2017. This decrease was primarily related to a decrease of approximately $848,000 related to a delay in the quarterly re-stocking order for handpieces and devices from Henry Schein. The third quarter re-stocking order was received and shipped in October 2018 in the amount $773,000. International dental revenue decreased approximately $326,000 for the three months ended September 2018 compared to 2017. China revenue decreased for three months ended September 30, 2018 by approximately $56,000 compared to 2017, as for the quarter ending September 30, 2018, the Company recognized $300,000 in revenue previously deferred until payment was received by Milestone Scientific.

**Gross profit for three months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $(120,205) | $1,809,273 | $(1,929,478) | -106.64% |
| Medical | - | - | - | 0.00 % |
| Total gross profit | $(120,205) | $1,809,273 | $(1,929,478) | -106.64% |

Consolidated gross profit for the three months ended September 30, 2018 included a reserve of approximately $273,000 for certain dental handpieces. A claim has been made for reimbursement of this purchase to the broker and manufacture that provided the handpieces to the Company. The gross profit percentages for three months ended September 30, 2018 and 2017 were approximately -7% and 63%, respectively. For the three months ended September 30, 2018, the Company recorded an allowance for handpieces and devices sold to Milestone China of approximately $790,000.

**Selling, general and administrative expenses for three months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $772,943 | $1,097,684 | $(324,741) | -29.58% |
| Medical | 454,306 | 501,054 | (46,748) | -9.33 % |
| Corporate | 1,658,832 | 1,607,258 | 51,574 | 3.21 % |
| Total selling, general and administrative expenses | $2,886,081 | $3,205,996 | $(319,915) | -9.98 % |

Consolidated selling, general and administrative expenses for the three months ended September 30, 2018 and 2017 were $2.8 million and $3.2 million, respectively. The decrease of approximately $320,000 is primarily related to an decrease compensation, marketing and professional fees of approximately $373,000 offset by a decrease in general expense, and employee related expenses of approximately $53,000 for the three months ending September 30, 2018.

Additionally, during the quarter Milestone Scientific charged approximately $1.5 million to the Corporate segment for an impairment of long-lived assets (Apad patents).

**Research and Development for three months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | | % |
|---|---|---|---|---|

| | | | Increase Decrease | |
|---|---|---|---|---|
| Dental | $- | $- | $- | 0.00 % |
| Medical | - | 16,884 | (16,884 ) | -100.00% |
| Corporate | 1,500 | - | 1,500 | 100.00 % |
| Total research and development | $1,500 | $16,884 | $(15,384 ) | -91.12 % |

Consolidated research and development expenses for the three months ended September 30, 2018 and 2017 were approximately $1,500 and $17,000, respectively. The decrease is due to a delay in the development of the cosmetic injection device during the second quarter of 2018.

**Loss from Operations for three months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $(893,148 ) | $711,589 | $(1,604,737) | -225.51% |
| Medical | (454,306 ) | (517,938 ) | 63,632 | 12.29 % |
| Corporate | (3,200,126) | (1,607,258) | (1,592,868) | -99.10 % |
| Total loss from operations | $(4,547,580) | $(1,413,607) | $(3,133,973) | -221.70% |

The loss from operations for the three months ended September 30, 2018 and 2017 was approximately $4.5 million and $1.4 million, respectively, an increase of approximately $3.1 million. As noted above, third quarter sales decreased by approximately $1.2 million and gross profit by approximately $1.9 million offset by a reduction of approximately $320,000 in selling, general and administrative expenses and increase of approximately $1.5 million for the write-down of long- lived assets(Apad Patents) accounted for the loss from operations for the three months ending September 30, 2018. The dental segment of the business continues to control expenses for a stable market. Costs in the medical segment are increasing as personnel are expanded in the U.S. to focus on our domestic Epidural device business.

**Nine months ended September 30, 2018 compared to nine months ended September 30, 2017**

**Net sales for nine months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $5,780,251 | $9,066,550 | $(3,286,299) | -36.25 % |
| Medical | 76,100 | - | 76,100 | 100.00% |
| Total sales, net | $5,856,351 | $9,066,550 | $(3,210,199) | -35.41 % |

Consolidated net sales for the nine months ended September 30, 2018 and 2017 were approximately $5.8 million and $9.1 million, respectively. Dental revenue for the nine months ended September 30, 2018 and 2017 were $5.7 million and $9.1 million, respectively. Dental revenue decreased $3.2 million during the nine months ended September 30, 2018, compared to 2017.

The domestic dental revenue decrease of approximately $1.5 million is related to a delay in the quarterly re-stocking order for handpieces and devices from Henry Schein and their focus on working through the inventory purchased in the fourth quarter of 2017. The third quarter re-stocking order was received and shipped in October 2018 in the amount of $773,000. Henry Schein's inventory of handpieces was less than a half month supply as of September 30, 2018. The receipt of the re-stocking order post-September 30 resulted in out stock positioning for Henry Schein’s customers in October 2018 until the order was shipped. International dental revenue excluding China decreased by approximately $350,000 for the nine months ended September 2018 compared to 2017. China revenue decreased for nine months ended September 30, 2018 by approximately $1.4 million compared to 2017, as the Company recognized $300,000 in revenue previously deferred until payment was received by Milestone Scientific. Milestone China is working through inventory purchases from 2017 and making modifications to their business strategy to better serve the Chinese dental market.

**Gross Profit (loss) for nine months ended September 30, 2018 and 2017 were as follows**

| 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Dental | $2,710,882 | $5,746,139 | $(3,035,257) | -52.82 % |
| Medical | (180,872 ) | - | (180,872 ) | -100.00% |
| Total gross profit | $2,530,010 | $5,746,139 | $(3,216,129) | -55.97 % |

Consolidated gross profit for the nine months ended September 30, 2018 and 2017 were approximately 43% and 63% respectively. The gross profit dollars in 2018 decreased to $2.5 million from $5.7 million in 2017, or by $3.2 million over the same period year over year. The gross profit dollars decrease relates to a decrease of approximately $3.2 million in revenue, reserve for slow moving inventory of approximately $289,000 and a reserve of approximately $273,000 for certain dental handpieces. A claim has been made for reimbursement of this purchase to the broker and manufacture that provided the handpieces to the Company. For the three months ended September 30, 2018, the company recorded an allowance for handpieces and devices sold to Milestone China of approximately $790,000.

**Selling, general and administrative expenses for nine months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $2,591,269 | $3,195,540 | $(604,271) | -18.91% |
| Medical | 1,762,972 | 1,629,598 | 133,374 | 8.18 % |
| Corporate | 4,394,244 | 4,170,954 | 223,290 | 5.35 % |
| Total selling, general and administrative expenses | $8,748,485 | $8,996,092 | $(247,607) | -2.75 % |

Consolidated selling, general and administrative expenses for the nine months ended September 30, 2018 and 2017 were approximately $8.7 million and $9.0 million respectively. The decrease of approximately $247,000 is primarily related to an decrease in compensation, marketing and professional fees of approximately $653,000 and a decrease in general expense, and employee related expenses of approximately $406,000 for the three months ending September 30, 2018.

Additionally, during the quarter Milestone Scientific charged approximately $1.5 million to the Corporate segment for an impairment of long-lived assets (Apad patents).

**Research and Development for nine months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $- | $3,000 | $(3,000 ) | -100.00% |
| Medical | 65,008 | 116,793 | (51,785 ) | -44.34 % |
| Corporate | 150,647 | 122,171 | 28,476 | 23.31 % |
| Total research and development | $215,655 | $241,964 | $(26,309 ) | -10.87 % |

Consolidated research and development expenses for the nine months ended September 30, 2018 and 2017 were approximately $215,000 and $241,000, respectively. The decrease is due a delay in the development of the cosmetic

injection device during the second and third quarter of 2018.

**Profit (Loss) from Operations for nine months ended September 30, 2018 and 2017 were as follows:**

| | 2018 | 2017 | Increase Decrease | % |
|---|---|---|---|---|
| Dental | $119,613 | $2,547,599 | $(2,427,986) | -95.30 % |
| Medical | (2,008,852) | (1,746,391) | (262,461 ) | -15.03 % |
| Corporate | (6,084,685) | (4,293,125) | (1,791,560) | -41.73 % |
| Total loss from operations | $(7,973,924) | $(3,491,917) | $(4,482,007) | -128.35% |

The loss from operations for the nine months ended September 30, 2018 and 2017 was approximately $8 million and $3.5 million, respectively, an increase of approximately $4.5 million.  As noted above, sales and gross profit decreased by approximately $3.2 million for the nine months ending September 30, 2018. The decrease in gross profit is related to a reserve for slow moving inventory of  approximately $289,000 and a reserve of approximately $273,000 for certain dental handpieces. A claim has been made for reimbursement of this purchase to the broker and manufacture that provided the handpieces to the Company. For the nine months ended September  30, 2018, the Company recorded an allowance for handpieces and devices sold to Milestone China of approximately $790,000.

Additionally, during the quarter Milestone Scientific charged approximately $1.5 million to the Corporate segment for an impairment of long-lived assets (Apad patents). The dental segment of the business continues to control expenses for a stable market. Costs in the medical segment are increasing as personnel are expanded in the U.S. to focus on our domestic Epidural device business.

**Liquidity and Capital Resources**

At September 30, 2018, Milestone Scientific had cash and cash equivalents of $0.4 million, total current assets of approximately $7 million and working capital of approximately $0.5 million. Based on the delayed payment for shipments made to Milestone China in 2017 and 2018, substantial doubt exists about the company’s liquidity and ability to continue as a going concern as of September 30, 2018.

Management as of September 30, 2018, believes that without the collection of the Milestone China Accounts Receivable (a reserve for non-collectability was established of approximately $1.3 million), and provided that the Company's sales performance, selling expenditures for its Epidural medical device, and the new product development programs deviate from management’s plan, the Company will not be able to meet its anticipated obligations over the next twelve months from the financial reporting date. Significant deviations, together with limitations on funding could require a delay, scale back or elimination of some or all of the Company’s development programs which could have a material adverse impact on the Company.

Milestone Scientific has incurred annual operating losses and negative cash flows from operating activities since its inception. The capital raised in December 2016 and January 2017 provided Milestone Scientific with working capital to continue to develop its medical devices and obtain FDA regulatory clearance of its *CompuFlo* Epidural System, as well as to market its dental devices. Milestone Scientific is actively pursuing the generation of positive cash flows from operating activities through an increase in revenue from its dental business worldwide and a reduction in operating expenses.

Now that the *CompuFlo* Epidural System has obtained FDA clearance in the United States, the Company's development costs should be lower in 2018. The FDA clearance will provide the Company with the opportunity to establish distribution in the U.S. At the same time, the Company is looking to establish additional financing opportunities to help with the commercialization of the Epidural device. In June 2018, Milestone Scientific filed a new 510(k) application for its intra-articular device. Most of the cost associated with this application were internal personnel cost and some low level third party review expense.

Milestone Scientific believes that the FDA clearance of its 510(k) applications with respect to the *CompuFlo* Epidural System will provide Milestone Scientific with the opportunity to enter the US medical device market and generate revenues in the future. Milestone Scientific believes that it has sufficient inventory of epidural devices to satisfy the near-term marketing opportunities.

In February and March 2018 Milestone Scientific hired an Executive VP of Global sales and Marketing and a Vice President of US Sales to fill a significant gap in our commercialization efforts of the *CompuFlo* Epidural System.

Milestone Scientific believes that the exclusive distribution agreement with Henry Schein will continue to improve its domestic revenues in 2018. To further reduce Milestone Scientific's expenditures, Milestone Medical is carefully managing expenses related to obtaining FDA clearance for the intra-articular devices.

Our condensed consolidated balance sheets included in this Quarterly Report reflect a decrease of approximately $4.9 million in current assets from December 31, 2017 to September 30, 2018. This decrease in current assets was primarily due to a reduction in cash, accounts receivable related party (due to a reserve for doubtful accounts), notes receivable, inventory (reserve for production problems with a dental accessory) and a charge for Impairment on the APAD patents (approximately $1.5 million), in the aggregate of approximately $5.1 million. This was partially offset by increases in and advances on contracts of approximately $.2 million.

In this Quarterly Report our consolidated balance sheets included a decrease in current liabilities of approximately $150,000 from approximately $6.7 million to approximately $6.5 million. This decrease is primarily due to a decrease in accrued expenses, accrued expenses related party, deferred revenue and deferred profit related party of approximately $945,000 and an increase in accounts payable and accounts payable related party of approximately $796,000.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Milestone Scientific is a “smaller reporting company” as defined by Regulation S-K and, as such, is not required to provide the information required by this item.

**Item 4. Controls and Procedures**

Milestone Scientific’s Interim Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of Milestone Scientific’s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, Milestone Scientific’s Interim Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures as of September 30, 2018 are effective to ensure that information required to be disclosed in the reports Milestone Scientific files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to Milestone Scientific's management, including the Interim Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. There have been no changes in Milestone Scientific’s internal control over financial reporting that occurred during Milestone Scientific’s last fiscal quarter that have materially affected, or that are reasonably likely to materially affect, Milestone Scientific’s internal controls over financial reporting.

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings**

Milestone Scientific is not involved in any material litigation.

**Item 1A. Risk Factors**

As a smaller reporting company, we are not required to provide the information required by this Item.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

In September 2018, the Company issued 18,497 shares of its common stock to an investor relation firm in connection with the provision of investor relations services to the Company.

In September 2018, the Company issued 28,572 and 9,494 shares of its common stock, respectively, to two consultants to the to the Company.

All of the above shares were issued pursuant to the exemption provided under Section 4(a)(2) the Securities Act of 1933, as amended.

**Item 3. DEFAULT UPON SENIOR SECURITIES**

None.

**Item 4. Mine Safety Disclosure**

Not applicable.

**Item 5. Other Information**

None

**Item 6. Exhibits and Financial Statement Schedules**

| Exhibit No. | Description |
|---|---|
| 31.1 | Rule 13a-14(a) Certification- Interim Chief Executive Officer * |
| 31.2 | Rule 13a-14(a) Certification- Chief Operating Officer, Chief Financial Officer (Principal Financial and Accounting Officer )* |
| 32.1 | Section 1350 Certifications- Interim Chief Executive Officer ** |
| 32.2 | Section 1350 Certifications- Chief Operating Officer, Chief Financial Officer (Principal Financial and Accounting Officer) ** |
| 101.INS | XBRL Instance Document* |
| 101.SCH | XBRL Taxonomy Extension Schema Document* |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document* |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document* |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document* |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document* |

* Filed herewith.

** Furnished herewith and not filed, in accordance with item 601(32) (ii) of Regulation S-K.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MILESTONE SCIENTIFIC INC.**

/s/ Leonard Osser
Leonard Osser
Interim Chief Executive Officer
(Principal Executive Officer)

/s/ Joseph D'Agostino
Joseph D'Agostino
Chief Operating Officer and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 14, 2018

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: times new roman; FONT-SIZE: 10pt"> $77.4  $97.1  $19.7   25.5%

| | | | | |
|---|---|---|---|---|
| Selling and marketing | 141.5 | 178.4 | 36.9 | 26.1 |
| General and administrative | 72.8 | 76.3 | 3.5 | 4.8 |
| Amortization of acquired intangible assets | 16.0 | 19.5 | 3.5 | 21.9 |

Research and Development, Net.  Research and development expenses, before capitalization of software development costs and government grants, increased to $102.2 million in 2010, as compared to $82.4 million in 2009 and represented 14.8% and 14.1% of revenues in 2010 and 2009, respectively.  Approximately 66% of the increase in research and development, net is attributed to an increase in cost of wages partially due to an increase in headcount following the Orsus and e-Glue acquisitions.

Capitalized software development costs remained at the same level of $1.3 million in 2010, as compared to 2009.  Amortization of capitalized software development costs included in cost of product revenues were $1.2 million and $0.9 million in 2010 and 2009, respectively.

Selling and Marketing Expenses.  Selling and marketing expenses increased to $178.4 million in 2010, as compared to $141.5 million in 2009, and represented 25.9% of total revenues in 2010, as compared to 24.3% in

2009. Approximately 84% of the increase in selling and marketing expense is attributed to an increase in cost of wages and sales incentives resulting from high performance in our business and the inclusion of Orsus and e-Glue. The remainder of the increase is mainly due to an increase in travel and exhibitions expenses

General and Administrative Expenses. General and administrative expenses increased to $76.3 million in 2010, as compared to $72.8 million in 2009, and represented 11.1% of total revenues in 2010, as compared to 12.5% in 2009. The increase in general and administrative expense is due mainly to an increase in cost of wages and an increase in rent and utilities costs. The increase is partially offset by a reduction in doubtful accounts expenses.

Amortization of acquired intangible assets. Amortization of acquired intangibles included in the operating expenses represent 2.8% and 2.7% of our 2010 and 2009 revenues, respectively. Approximately 69% of the increase in amortization of acquired intangible assets is attributable to amortization of intangible assets related to the acquisition of Fortent and Syfact for the entire year of 2010. The remainder is mainly due to amortization of intangible assets related to the acquisitions of Orsus and e-Glue.

Financial and Other Income

| | Years Ended December 31, (U.S. dollars in millions) | | | |
|---|---|---|---|---|
| | 2009 | 2010 | Dollar Change | Percentage Change |
| Financial income, net | $7.7 | $9.1 | $1.4 | 18.2 % |
| Other expenses, net | (0.1 ) | (0.1 ) | - | - |

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Financial Income, Net. The increase in financial income, net is attributable mainly to the increase in cash and cash equivalents and marketable securities balance in 2010 as compared to 2009.

Taxes on Income. In 2010 taxes on income amounted to $9.3 million, as compared to $3.0 million in 2009. Our effective tax rate amounted to 16.1% in 2010 compared with 6.6% in 2009. We experienced a relatively low effective tax rate in 2009 mainly due to the release of prior period provisions arising as a result of the unadjusted expiration of the statute of limitations for certain historic tax returns filed as well as the effects of a final settlement with a certain tax authority years prior to 2009. Our effective tax rate during 2010 returned to more normalized levels reflecting the geographical mix of where our profits are earned and the applicable tax rates thereon.

The decline of the corporate tax rate in Israel from 26% in 2009 to 25% in 2010 had a minor impact on our effective tax rate. This is because the majority of our income earned in Israel benefits from the reduced tax rates applicable to us as a result of our Approved and Privileged Enterprise programs.

Further information with regard to our Approved and Privileged Enterprise programs can be found in Item 3, “Risk Factors” under the caption “Our results may be affected by the availability of government grants and tax benefits. Our participation in these programs restricts our ability to freely transfer manufacturing rights and technology out of Israel” and in Note 13 of our Consolidated Financial Statements under the caption “Taxes on Income.”

Subject to unpredictable effects of any future settlements with tax authorities, unadjusted expiration of the statute of limitations, future changes in law or accepted practice and effects of potential mergers and acquisitions, we expect our effective tax rate (which includes effects of FIN No. 48 which has been incorporated into ASC 740) to be approximately 18% in the coming years.

Net Income. Net income was $48.7 million in 2010, as compared to $42.8 million in 2009. The increase in 2010 resulted primarily from the increase in revenues and an increase in gross margin.

Liquidity and Capital Resources

In recent years, the cash generated from our operating activities has financed our operations. Generally, we invest our excess cash in highly liquid investment grade securities. At December 31, 2011, we had $562.6 million of cash and cash equivalents and short-term and long-term investments, as compared to $663.2 million at December 31, 2010 and $548.5 million at December 31, 2009.

Cash provided by operating activities was $154.4 million, $145.0 million and $119.7 million in 2011, 2010 and 2009, respectively. Net cash from operations in 2011 consisted primarily of net income of $57.3 million and adjustments for non-cash activities including depreciation and amortization of $67.0 million, increase in accrued expenses and other liabilities of $35.6 million and stock-based compensation of $21.2 million which were partially offset by an increase in trade receivables of $20.6 million and deferred tax of $8.8 million. Net cash from operations in 2010 consisted primarily of net income of $48.7 million and adjustments for non-cash activities including depreciation and amortization of $57.1 million, an increase in accrued expenses and other liabilities of $25.9 million, stock-based compensation of $21.1 million, and a decrease in trade receivables of $6.3 million which were partially offset by a decrease in trade payables of $7.1 and deferred tax of $4.9 million. Net cash from operations in 2009 consisted primarily of net income of $42.8 million and adjustments for non-cash activities including depreciation and amortization of $47.2 million, stock-based compensation of $18.2 million, a decrease in trade receivables of $8.9 million, and an increase in accrued expenses and other liabilities of $12.0 million, which were partially offset by deferred tax of $7.0 million.

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Net cash provided by investing activities was $9.4 million in 2011. Net cash used in investing activities was $276.7 million and $71.3 million in 2010 and 2009, respectively. In 2011, net cash provided by investing activities consisted primarily of net proceeds from marketable securities of $174.2 million which funded payment for the acquisitions of Fizzback, Cybertech and other acquisitions of $143.4 million and purchase of property and equipment of $17.3 million. In 2010, net cash used in investing activities consisted primarily of net investment in marketable securities of $251.4 million, payment for the acquisitions of e-Glue, Orsus and other acquisitions of $52.3 million, and purchase of property and equipment of $11.7 million, which were partially offset by proceeds from short-term bank deposits of $40.0 million. In 2009, net cash used in investing activities consisted primarily of payment for the acquisition of Fortent and other acquisitions of $84.9 million and purchase of property and equipment of $8.9 million, which were partially offset by net proceeds from short-term bank deposits of $24.5 million.

Net cash used in financing activities was $68.8 million in 2011. Net cash provided by financing activities was $26.0 million and $20.9 million in 2010 and 2009, respectively. In 2011, net cash used in financing activities was attributed primarily to the repurchase of our ordinary shares of $95.9 million under the first program to repurchase ordinary shares in a total amount up to $100 million which were offset by proceeds from the issuance of shares upon exercise of options and purchase of shares under employee share purchase plans of $26.8 million. In 2010, net cash provided from financing activities consisted primarily of proceeds from the issuance of shares upon exercise of options and purchase of shares under employee share purchase plans of $26.0 million. In 2009, net cash provided from financing activities consisted primarily of proceeds from the issuance of shares upon exercise of options and purchase of shares under employee share purchase plans of $19.9 million. As of December 31, 2011, we had non-binding arrangements, for the rendering of credit lines from banks against our portfolio with those banks.

We believe that based on our current operating forecast, the combination of existing working capital and expected cash flows from operations will be sufficient to finance our ongoing operations for the next twelve months.

Research and Development

For information on our research and development policies, please see Item 4, “Information on the Company” in this annual report.

Trend Information

Our development efforts are aimed at addressing several industry trends, including: the growing need of organizations to analyze and respond to vast amounts of structured and unstructured data; heightened and more complex regulatory and compliance requirements; and more sophisticated security threats. Our development efforts are also influenced by technology trends, such as the evolution of real-time analytics and the proliferation of alternate communication channels to voice, such as chat, email, and social media.

In connection with our Customer Interaction Solutions, such industry trends include the evolution of contact centers into strategic customer interaction hubs, an increased focus on improving customer experience across the enterprise, contact centers seeking to impact customer interactions in real time, enterprises expanding their operational efficiency activities beyond the contact center, and increased adoption of contact center hosting solutions.

In connection with our Financial Crime and Compliance Solutions, such trends include enterprise-wide risk and compliance technology consolidation; the changing technology in the financial services market; and growth in emerging markets.

In the Security sector there is an increase in challenges for public safety, homeland security and intelligence agencies. These include emerging needs for holistic situational awareness and event management in the security market; increased focus on physical corporate security; increased urbanization that raises rates of crime and risks of terror attacks; and a requirement for increased service level, operational efficiency and business continuity.

For more information on trends in our industry, please see Item 4, “Information on the Company—Business Overview—Industry Background and Trends.”

For more information on uncertainties, demands, commitments or events that are reasonably likely to have a material effect on revenue, please see Item 3, “Key Information—Risk Factors.”

Contractual Obligations

Set forth below are our contractual obligations and other commercial commitments over the medium term as of December 31, 2011 (in thousands of U.S. dollars).

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1- 3 years | 3-5 years | More than 5 years |
| Operating Leases | 113,242 | 16,676 | 25,642 | 20,660 | 50,264 |
| Unconditional Purchase Obligations | 3,137 | 3,137 | | | |
| Severance Pay* | 23,728 | | | | |
| Total Contractual Cash Obligations | 140,107 | 19,813 | 25,642 | 20,660 | 50,264 |
| Uncertain Income Tax Positions ** | 43,435 | | | | |

*Severance pay relates to accrued obligations to employees as required under applicable labor laws. These obligations are payable only upon termination, retirement or death of the respective employees.

**Uncertain income tax positions under ASC 740 are due upon settlement and we are unable to reasonably estimate the ultimate amount or timing of settlement. See Note 13(h) of our Consolidated Financial Statements for further information regarding our liability under ASC 740.

| | | Amount of Commitment Expiration Per Period | | | |
|---|---|---|---|---|---|
| Other Commercial Commitments | Total Amounts Committed | Less than 1 year | 1- 3 years | 3-5 years | More than 5 years |
| Guarantees – continuing operations | 14,832 | 13,448 | 789 | 175 | 420 |

Qualitative and Quantitative Disclosure About Market Risk

For information on the market risks relating to our operations, please see Item 11, “Quantitative and Qualitative Disclosures about Market Risk” in this annual report.

Recently Issued Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board, or FASB, issued ASU 2001-08, Testing Goodwill for Impairment, codified in ASC 350 "Intangibles – Goodwill and Other". The revised accounting standard update intended to simplify how an entity tests goodwill for impairment. The amendment will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This accounting standard update will be effective for us beginning January 1, 2012. We do not expect that the adoption of this new guidance to have a material impact on our financial statements.

In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income, codified in ASC 220 "Comprehensive Income." The guidance requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance also eliminates the option to present the components of other comprehensive income as part of the statement of equity. The adoption of the standard will have no impact on our financial position or results of operations, but will result in a change in the presentation of our basic consolidated financial statements. We are currently evaluating whether to present other comprehensive income in a single continuous statement of comprehensive income or in two separate but consecutive statements.

In May 2011, the FASB issued ASU 2011-04 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, codified in ASC 820 "Fair Value Measurement". The guidance requires an entity to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements, and will become effective for us beginning January 1, 2012. We do not expect that the adoption of this new guidance will have a material impact on our financial statements.

Item 6. Directors, Senior Management and Employees.

Directors and Senior Management

The following table sets forth, as of March 13, 2012, the name, age and position of each of our directors and executive officers:

| Name | Age | Position |
|---|---|---|
| Ron Gutler(1)(4)(5) | 54 | Chairman of the Board of Directors |
| Joseph Atsmon(1)(3) | 64 | Vice-Chairman of the Board of Directors |
| Rimon Ben-Shaoul(2)(4) | 67 | Director |
| Yoseph Dauber(2)(3) | 76 | Director |
| Dan Falk(1)(2)(3)(4)(5)(6) | 67 | Director |
| Yocheved Dvir(1)(2)(3)(6) | 59 | Director |
| David Kostman(4) | 47 | Director |
| Zeev Bregman | 50 | President and Chief Executive Officer |
| Udi Ziv | 46 | President, Enterprise Group |
| Yaron Tchwella | 51 | President, Security Group and Executive Vice President Business Operation |
| Amir Orad | 36 | President and Chief Executive Officer, NICE-Actimize |
| Dafna Gruber | 47 | Chief Financial Officer |
| Yechiam Cohen | 55 | Corporate Vice President, General Counsel and Corporate Secretary |
| Eran Porat | 49 | Corporate Vice President, Finance |
| Eran Liron | 44 | Executive Vice President, Corporate Development |
| Benny Einhorn | 56 | Chief Marketing Officer |
| Yochai Rozenblat | 50 | President and Chief Executive Officer, NICE Americas |
| Ad Ketelaars | 55 | President, NICE EMEA |
| Raghav Sahgal | 49 | President, NICE APAC |
| Sigal Gillmore | 42 | Executive Vice President, Human Resources |

(1) Member of the Audit Committee.
(2) Member of the Compensation Committee.
(3) Member of the Internal Audit Committee.
(4) Member of the Mergers and Acquisitions Committee.
(5) Member of the Nominations Committee.
(6) Outside Director. See Item 6, "Directors, Senior Management and Employees—Board Practices— Outside Directors."

At our annual meeting of shareholders held on September 19, 2011, John Hughes announced that he would not stand for re-election to the Board of Directors.

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Set forth below is a biographical summary of each of the above-named directors and executive officers of NICE. Each of our directors qualifies as an independent director under applicable NASDAQ rules.

Ron Gutler has served as one of our directors since May 2001 and he is the Chairman of the Board since May 2002. Mr. Gutler is currently a director of Psagot Investment House, Psagot Securities, Poalim Securities USA Inc., and a member of the Advisory Board of Poalim Real Estate (part of Poalim Capital Market Group). Between 2000 and 2011, he served as the Chairman of G.J.E. 121 Promoting Investment Ltd., a real estate company. Between 2000 and 2002, Mr. Gutler managed the Blue Border Horizon Fund, a global macro fund. Mr. Gutler is a former Managing Director and a Partner of Bankers Trust Company (currently part of Deutsche Bank). Between 1987 and 1999, he held various positions with Bankers Trust, where Mr. Gutler headed its trading and sales activities in Asia, South America and Emerging Europe. He also established and headed the Israeli office of Bankers Trust. Mr. Gutler holds a Bachelor’s degree in Economics and International Relations and a Master’s degree in Business Administration, both from the Hebrew University in Jerusalem.

Joseph Atsmon has served as one of our directors since September 2001 and Vice-Chairman of the Board since May 2002. Mr. Atsmon currently serves as a director of Ceragon Networks Ltd. and Radvision Ltd. From 1995 until 2000, Mr. Atsmon served as Chief Executive Officer of Teledata Communications Ltd., a public company acquired by ADC Telecommunications Inc. in 1998. Mr. Atsmon had a twenty-year career with Tadiran Ltd. In his last role at Tadiran Ltd., Mr. Atsmon served as Corporate VP for business development. Prior to that, he served as President of various military communications divisions. Mr. Atsmon holds a Bachelor’s degree in Electrical Engineering from the Technion – Israel Institute of Technology.

Rimon Ben-Shaoul has served as one of our directors since September 2001. Since 2001, Mr. Ben-Shaoul has served as Co-Chairman, President, and Chief Executive Officer of Koonras Technologies Ltd., a technology investment company controlled by LEADER Ltd., an Israeli holding company. Mr. Ben-Shaoul also serves as a director of MIND C.T.I. Ltd. and several private companies, and served as a director of BVR Systems Ltd. In addition, he is the President and Chief Executive Officer of Polar Communications Ltd., which manages media and communications investments. Mr. Ben-Shaoul also serves as the Chairman of T.A.T Technologies Ltd., a public company listed on NASDAQ and TASE. Between 1997 and 2001, Mr. Ben-Shaoul was the President and Chief Executive Officer of Clal Industries and Investments Ltd., one of the largest holding companies in Israel with substantial holdings in the high tech industry. During that time, Mr. Ben-Shaoul also served as Chairman of the Board of Directors of Clal Electronics Industries Ltd., Scitex Corporation Ltd., and various other companies within the Clal Group. Mr. Ben-Shaoul also served as a director of ECI Telecom Ltd., Fundtech Ltd., Creo Products, Inc. and Nova Measuring Instruments Ltd. From 1985 to 1997, Mr. Ben-Shaoul was President and Chief Executive Officer of Clal Insurance Company Ltd. and a director of the company and its various subsidiaries. Mr. Ben-Shaoul holds a Bachelor’s degree in Economics and Statistics and a Master’s degree in Business Administration, both from Tel-Aviv University.

Yoseph Dauber has served as one of our directors since April 2002. Mr. Dauber has served in various senior positions at Bank Hapoalim since 1973. Until June 2002, Mr. Dauber was Deputy Chairman of the Board of Management and Joint Managing Director of Bank Hapoalim and was responsible for the commercial division of the bank. From 1994 to June 2002, Mr. Dauber served as Chairman of the Isracard Group. From 1995 to July 2002, Mr. Dauber also served as Chairman of Poalim American Express. From 2002 to 2003, he served as Chairman of the Israel Maritime Bank Ltd. and from 2003 to 2008 he served as a director of Bank Hapoalim. Mr. Dauber currently serves as a director of MagicJack Vocaltec Ltd., Orbit Technologies Ltd., Delek Group Ltd., S.Shlomo Holdings Ltd and Chairman of KCPS Manof Fund. Mr. Dauber holds a Bachelor’s degree in Economics and Statistics from the Hebrew University in Jerusalem and a Master’s degree in Law from Bar Ilan University.

Dan Falk has served as one of our statutory outside directors since 2001. From 1999 to 2000, Mr. Falk was President and Chief Operating Officer of Sapiens International Corporation N.V. From 1985 to 1999, Mr. Falk served in various positions in Orbotech Ltd., the last of which were Chief Financial Officer and Executive Vice President. From 1973 to 1985, he served in several executive positions in the Israel Discount Bank. Mr. Falk also serves as the Chairman of ORAD Hi-Tech Systems Ltd., and serves on the board of directors of Orbotech Ltd., Ormat Technologies Inc., Attunity Ltd., Nova Measuring Systems Ltd., Amiad Filteration Systems Ltd., Plastopil Ltd. and Oridion Medical Ltd. Mr. Falk holds a Bachelor’s degree in Economics and Political Science and a Master’s degree in Business Administration, both from the Hebrew University, Jerusalem.

Yocheved Dvir has served as one of our statutory outside directors since January 2008. Since 2000, Ms. Dvir has served as a strategic advisor in business development affairs to multiple companies and initiatives that were being founded. Ms. Dvir also serves on the board of directors of Alrov Real Estate, Visa Cal and Applisonix Ltd. Until recently, she served on the boards of Trendline Business Information & Communications Ltd., Menorah Insurance Company Ltd., Israel Corporation Ltd., ECI Telecom Ltd., Strauss Industries Ltd., Phoenix Holding and Phoenix Insurance Co. Between 1990 and 2000, Ms. Dvir served as a Senior Vice President of the Migdal Group. Ms. Dvir joined the Migdal Group in 1981 and, until late 2000, held a number of senior financial and managerial positions, including Head of the Group’s Economics Department (1986-1988), Head of the Group’s Corporate Office (1989-1992), Head of the Group’s General Insurance Division and Corporate Office (1993-1997), Group CFO (1997-1999), Head of the Group’s Strategic Development Division and Marketing Array and Risk Manager (2000). Ms. Dvir holds a Bachelor’s degree in Economics and Statistics from the University of Haifa and a full second degree in Statistics from the Hebrew University of Jerusalem.

David Kostman has served as one of our directors since 2001, with the exception of a short period between June 2007 and July 2008. Mr. Kostman is currently Chairman and Chief Executive Officer of Nanoosh LLC, a restaurant operating company, and serves on the board of directors of Retalix Ltd. and The Selling Source, LLC. From 2006 until 2008, Mr. Kostman was a Managing Director in the investment banking division of Lehman Brothers, heading the Global Internet Group. From April 2003 until July 2006, Mr. Kostman was Chief Operating Officer and then Chief Executive Officer of Delta Galil USA, a subsidiary of Delta Galil Industries Ltd., a NASDAQ-listed apparel manufacturer. From 2000 until 2002, Mr. Kostman was President of the International Division and Chief Operating Officer of VerticalNet, Inc., a NASDAQ-listed internet and software company. Mr. Kostman holds a Bachelor’s degree in Law from Tel Aviv University and a Master’s degree in Business Administration from INSEAD.

Zeev Bregman has served as our President and Chief Executive Officer since September 2009. From 2001 to 2007, Mr. Bregman served as Chief Executive Officer of Comverse Inc. From 1987 to 2001, he served in various research and development, sales, marketing, and management positions within Comverse, including Vice President Head of the EMEA division, Vice President and Head of the Messaging division, and Chief Operating Officer. Mr. Bregman holds a Bachelor's degree in Mathematics and Computer Science from Tel-Aviv University, a Master's degree in Computer Science from Tel-Aviv University and a Master's degree in Business Administration from a joint program of Kellogg Business School and Tel Aviv University.

Udi Ziv has served as President of the Enterprise Group since January 2009. From 2001 until 2007, Mr. Ziv held several senior executive positions with SAP AG, a leading global enterprise software company, including General Manager of SAP's Small Business Solutions, Managing Director of SAP Labs Israel and Vice President responsible for the research and development of the SAP Portal product. Prior to joining SAP, Mr. Ziv was one of the original members, and the head of global research & development, of Top Tier Software, a leading enterprise portal company (acquired by SAP in 2001). Mr. Ziv holds a Bachelor of Science degree in Computer Engineering from the Technion – Israel Institute of Technology.

Yaron Tchwella has served as President of the Security Group and Executive Vice President, Business Operation since June 2011. Prior to joining NICE he served as chief executive officer of Blue Phoenix Solutions Ltd. During 2007 and 2008 Mr. Tchwella served as President of Comverse Inc. Prior to this position and as part of his 10 years at Comverse, Mr. Tchwella served as president of the Messaging Division and a member of the executive management team at Comverse. Mr. Tchwella also held various executive managerial positions within the product, services and customer-facing organizations at Comverse. Prior to joining Comverse, Mr. Tchwella held engineering and managerial positions over a 13-year period in the security and defense division at Advanced Technology Ltd., known today as Ness Technology Ltd. Mr. Tchwella holds a Bachelor's degree in Electronic Engineering from Tel Aviv University.

Amir Orad has served as President and Chief Executive Officer of NICE-Actimize since April 2010. From 2007 until 2010, Mr. Orad served in various positions in NICE-Actimize, including President of the Americas, Executive Vice President of Product Management and Business Development, and Chief Marketing Officer. From 2005 until 2006, Mr. Orad was VP Marketing of RSA Security and from 1999 until 2005, he was a member of the founding team and Eexecutive Vice President of Marketing of Cyota Inc., an online security and anti-fraud company that was acquired by RSA Security. Mr. Orad holds an MBA from Columbia University's executive program and a B.S. in Computer Science and Management from Tel Aviv University.

Dafna Gruber has served as our Chief Financial Officer since June 2007. From 2001 until May 2007, she served as the Chief Financial Officer of Alvarion Ltd., a NASDAQ-listed company that provides innovative wireless network solutions. From 1997 to 2001, Ms. Gruber was the Chief Financial Officer of BreezeCOM Ltd., which was merged with Floware Wireless Systems Ltd. to create Alvarion, prior to which she was the controller of BreezeCOM from 1996 to 1997. From 1993 to 1996, Ms. Gruber was a controller at Lannet Data Communications Ltd., subsequently acquired by Lucent Technologies Inc. Ms. Gruber is a certified public accountant and holds a Bachelor’s degree in Accounting and Economics from Tel Aviv University.

Yechiam Cohen has served as our Corporate Vice President, General Counsel and Corporate Secretary since 2005. From 1996 to 2004, he served as General Counsel of Amdocs, a leading provider of billing and CRM software solutions to the telecommunications industry. Before joining Amdocs, Mr. Cohen was a partner in the Tel Aviv law firm of Dan Cohen, Spigelman & Company. From 1987 to 1990, he was an associate with the New York law firm of Dornbush, Mensch, Mandelstam and Schaeffer. Mr. Cohen served as a law clerk to Justice Beijski of the Supreme Court of Israel in Jerusalem. He holds a Bachelor’s degree from the Hebrew University School of Law and is admitted to practice law in Israel and New York.

Eran Porat has served as our Corporate Vice President, Finance since 2004. From March 2000 to 2004, he served as our Corporate Controller. From 1997 to February 2000, Mr. Porat served as Corporate Controller of Tecnomatix Technologies Ltd. From 1996 to 1997, he served as Corporate Controller of Nechushtan Elevators Ltd. Mr. Porat is a certified public accountant and holds a Bachelor’s degree in economics and accounting from Tel Aviv University.

Eran Liron has served as our Executive Vice President, Corporate Development since February 2006. From 2004 to 2006, he served as Director of Corporate Development at Mercury Interactive Corporation, a software company, and prior thereto he held several business development positions at Mercury Interactive. Before joining Mercury, Mr. Liron served in several marketing roles at software startups and at Tower Semiconductor. Mr. Liron holds a Bachelor of Science degree from the Technion – Israel Institute of Technology and a Doctorate in Business from the Stanford Graduate School of Business in California.

Benny Einhorn has served as our Chief Marketing Officer since April 2010. From 2008 to 2009, Mr. Einhorn served as the Vice President of Sales & Marketing in Modu, an innovative manufacturer of the world’s lightest modular mobile phones. From 2001 to 2008, he was the Chief Marketing Officer and President of EMEA at Comverse Inc. Mr. Einhorn holds an MBA degree and a Bachelor's degree in Industrial Engineering from Tel Aviv University.

Yochai Rozenblat has served as President and Chief Executive Officer of our American division since September 2009. Prior to his current position, Mr. Rozenblat was President of the Enterprise Group in the Americas. From 2003 to 2007, Mr. Rozenblat served as our Vice President of Sales, responsible for North America and from 2007 his responsibilities also extended to South America. Before joining NICE in 2004, Mr. Rozenblat led the Enterprise Sales Team at Clarify, the CRM division of Amdocs. Mr. Rozenblat has a Bachelor’s degree in Law from Tel Aviv University.

Ad Ketelaars has served as President of NICE EMEA since July 2011. From 2008 to 2011, he served as the CEO of CyberTech, and joined NICE in connection with the acquisition of CyberTech. Mr. Ketelaars' professional background is vast and before joining CyberTech, among other positions, he was the EMEA President of Richardson Electronics, the CEO of Comsys an IVR and Voicemail company, the CEO of EnerTel, a Dutch telecom operator, and the CEO of Philips Business Communication and its successor NEC Philips Unified Solutions. Mr. Ketelaars holds a master degree in industrial engineering and an MBA from INSEAD.

Raghav Sahgal has served as President of NICE APAC since October 2010. From 2008 to 2010, Mr. Sahgal served as Vice President, Communications, Global Business Unit – APAC of Oracle. Prior to that, Mr. Sahgal held various senior positions in the management, strategic planning, global field operations, sales and marketing groups at Intense Technologies Inc., Suntec Inc., Comverse Technology, CSG Systems and Lucent Technologies. Mr. Sahgal is a graduate of the Harvard Business School Executive General Management Program, has a Master's degree in Computer System Management from the University of Maryland and a Bachelor's degree in Computer Engineering from Tulane University.

Sigal Gillmore has served as Executive Vice President, Human Resources since September 2009. From 1996 until 2009, Ms. Gillmore held several field, regional and corporate roles at Microsoft. In her most recent role at Microsoft, Ms. Gillmore led the staffing function across all international regions (EMEA, Asia, Latin America) overseeing both Sales and R&D sites. Ms. Gillmore holds a Masters degree in organizational behavior from Tel Aviv University.

There are no family relationships between any of the directors or executive officers named above.

Compensation

The aggregate compensation paid to or accrued on behalf of all our directors and executive officers as a group of 24 persons during 2011 consisted of approximately $9.7 million in salary, fees, bonus, commissions and directors' fees and approximately $0.7 million in amounts set aside or accrued to provide pension, retirement or similar benefits, but excluding amounts we expended for automobiles made available to our officers, expenses (including business travel, professional and business association dues and expenses) reimbursed to our officers and other fringe benefits commonly reimbursed or paid by companies in Israel.

We have a performance based bonus plan for our executive management team. The plan is based on our overall performance, the particular unit performance, individual performance and the results of the customer satisfaction survey conducted annually. The measurements can change year over year, and are a combination of financial parameters, including revenues, booking, operating income and collection. The plan is reviewed and approved by our Board of Directors annually, as is any bonus payment under the plan.

During 2011, our officers and directors received, in the aggregate, options to purchase 529,500 ordinary shares and 17,500 restricted share units under our equity based compensation plans. The options have a weighted average price of $26.41 and will expire six years after the date of grant. The restricted shares units are granted at par value of the ordinary shares. For information regarding our option exchange program, see "–Share Ownership–Option Exchanges and Price Adjustment" below.

Pursuant to the requirements of the Israeli Companies Law, 5759–1999, or the Israeli Companies Law, remuneration of our directors generally requires shareholder approval. Compensation and reimbursement for outside directors (as described below) is statuto–rily determined pursuant to the Israeli Companies Law. Effective as of July 29, 2008, our shareholders approved the payment to each of our directors, including outside directors, of an annual fee of NIS 90,000 (equivalent to approximately $26,040) and a meeting attendance fee of NIS 3,250 (equivalent to approximately $940), including for meetings of committees of the board of directors. The cash amounts set forth above are subject to adjustment for changes in the Israeli consumer price index after December 2007.

On June 29, 2010, at our 2010 annual general meeting of shareholders, our shareholders approved the increase of the Chairman of the Board's special annual cash fee from NIS 180,000 (equivalent to approximately $49,223) to NIS 390,000 (equivalent to approximately $106,649). The special annual fee is subject to adjustment for changes in the Israeli consumer price index after June 2010.

Board Practices

Corporate Governance Practices

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

General Board Practices

Our articles of association provide that the number of directors serving on the board shall be not less than three but shall not exceed thirteen. Our directors, other than outside directors, are elected at the annual shareholders meeting to serve until the next annual meeting or until their earlier death, resignation, bankruptcy, incapacity or removal by an extraordinary resolution of the general shareholders meeting. Directors may be re-elected at each annual shareholders meeting. The board may appoint additional directors (whether to fill a vacancy or create new directorships) to serve until the next annual shareholders meeting, provided, however, that the board shall have no obligation to fill any vacancy unless the number of directors is less than three.

The board may, subject to the provisions of the Israeli Companies Law, appoint a committee of the board and delegate to such committee all or any of the powers of the board, as it deems appropriate. Notwithstanding the foregoing, the board may, at any time, amend, restate or cancel the delegation of any of its powers to any of its committees. The board has appointed an internal audit committee under the Israeli Companies Law that has four members, an audit committee that has four members, a compensation committee that has four members, a nominations committee that has two members and a mergers and acquisitions committee that has four members. We do not have, nor do our subsidiaries have, any directors' service contracts granting to the directors any benefits upon termination of their employment.

Outside Directors

Under the Israeli Companies Law, companies incorporated under the laws of Israel whose shares have been offered to the public in or outside of Israel are required to appoint at least two "outside" directors.

Outside directors are required to possess professional qualifications as set out in regulations promulgated under the Israeli Companies Law. The Israeli Companies Law provides that a person may not be appointed as an outside director if (i) such person or person's relative or affiliate has, at the date of appointment, or had at any time during the two years preceding such date, any affiliation with the company, a controlling shareholder thereof or their respective affiliates; or (ii) in a company that does not have a 25% shareholder, such person has an affiliation with any person who, at the time of appointment, is the chairman, the chief executive officer, the chief financial officer or a 5% shareholder of the company. In general, the term "affiliation" includes:

an employment relationship;

a business or professional relationship maintained on a regular basis;

control; and

service as an office holder.

No person may serve as an outside director if the person's position or other activities create, or may create a conflict of interest with the person's responsibilities as an outside director or may otherwise interfere with the person's ability to serve as an outside director. Until the lapse of two years from termination of office, a company or its controlling shareholder may not give any direct or indirect benefit to the former outside director.

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

- the majority of shares voted at the meeting shall include at least a majority of the shares of non-controlling shareholders present at the meeting and voting on the matter (without taking into account the votes of the abstaining shareholders); or

- the total number of shares of non-controlling shareholders voted against the election of the outside directors does not exceed two percent of the aggregate voting rights in the company.

The initial term of an outside director is three years and may be extended for up to two additional three-year terms. Thereafter, he or she may be reelected by our shareholders for additional periods of up to three years each only if the audit committee and the board of directors confirm that, in light of the outside 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. Reelection of an outside director may be effected through one of the following mechanisms: (1) the board of directors proposed the reelection of the nominee and the election was approved by the shareholders by the majority required to appoint outside directors for their initial term; or (2) a shareholder holding one percent or more of a company's voting rights proposed the reelection of the nominee, and the reelection is approved by a majority of the votes cast by the shareholders of the company, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders, provided that the aggregate votes cast in favor of the reelection by such non-excluded shareholders constitute more than two percent of the voting rights in the company. Each committee of a company's board of directors which is empowered to exercise any of the board's powers is required to include at least one outside director.

Mr. Dan Falk was elected for a fourth term as an outside director and Ms. Yocheved Dvir was elected for a second term as an outside director at our Annual General Meeting held on June 29, 2010, and their election became effective as of January 1, 2011. An outside director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, from the company. In accordance with such regulations, our shareholders approved that our outside directors are to receive compensation equal to that paid to the other members of the board of directors. For further information, please see Item 6, "Directors, Senior Management and Employees—Compensation" in this annual report.

Financial and Accounting Expertise

Pursuant to new provisions of the Israeli Companies Law effective from April 2006, our board of directors has determined that at least one member of our board of directors must be an "accounting and financial expert." The Israeli Companies Law requires that all outside directors must be "professionally qualified." Under applicable NASDAQ rules, each member of our audit committee must be financially literate and at least one of the members must have experience or background that results in such member's financial sophistication. Our board of directors has determined that Dan Falk is an "accounting and financial expert" for purposes of the Israeli Companies Law and is financially sophisticated for purposes of applicable NASDAQ rules. See also Item 16A, "Audit Committee Financial Expert" in this annual report.

Independent Directors

Under the rules of the NASDAQ, a majority of our directors are required to be "independent" as defined in applicable NASDAQ rules. All of our directors satisfy the respective independence requirements of NASDAQ.

In addition, our Articles of Association provide that, if we do not have a shareholder that holds 25% or more of our issued and outstanding share capital, then a majority of the directors shall be "independent" as defined in the Israeli Companies Law and the regulations promulgated thereunder. If we have a shareholder that holds 25% or more of our issued and outstanding share capital, then at least one third of the directors shall be "independent." All of our directors satisfy the respective independence requirements of the Israeli Companies Law.

Internal Audit Committee

The Israeli Companies Law requires public companies to appoint an internal audit committee. The role of the internal audit committee under the Israeli Companies Law is to examine flaws in the management of the company's business in consultation with the internal auditors and the independent accountants, and to propose remedial measures to the board. The internal audit committee also reviews interested party transactions for approval as required by law, including approval of the remuneration of a director in any capacity, which also requires Board, Compensation Committee and shareholder approval. The internal audit committee also assesses our internal audit system and the performance of our internal auditor, and oversees the implementation and enforcement of our compliance program. Under the Israeli Companies Law, an internal audit committee must consist of at least three directors, including all of the outside directors. The members of the internal audit committee must satisfy certain independence standards under the Israeli Companies Law, and the chairman of the internal audit committee must be an outside director. The chairman of the board of directors, any director employed by the company or by its controlling shareholder or by an entity controlled by the controlling shareholder, a director who regularly provides services to the company or to its controlling shareholder, any director who derives most of its income from the controlling shareholder and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the internal audit committee. All of the current members of our internal audit committee (presently comprised of Yocheved Dvir (Chairman), Joseph Atsmon, Dan Falk and Yoseph Dauber) meet these qualifications.

Internal Auditor

Under the Israeli Companies Law, the board of directors must appoint an internal auditor, proposed by the internal audit committee. The role of the internal auditor is to examine, among other matters, whether the company's activities comply with the law and orderly business procedure. Under the Israeli Companies Law, the internal auditor may be an employee of the company but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of the company's independent accounting firm or its representative. We have appointed an internal auditor in accordance with the requirements of the Israeli Companies Law.

Audit Committee

The NASDAQ rules also require that the audit committee of a listed company must be composed of at least three directors, each of whom is (i) independent; (ii) does not receive any compensation (except for board fees) from the company; (iii) is not an affiliated person of the company or any subsidiary; and (iv) has not participated in the preparation of the company's (or a current subsidiary's) financial statements during the past three years. All of the current members of our audit committee (presently comprised of Joseph Atsmon (Chairman), Ron Gutler, Dan Falk and Yocheved Dvir) meet the NASDAQ standards described above.

Our audit committee has adopted a charter specifying the committee's purpose and outlining its duties and responsibilities which include, among other things, (i) appointing, retaining and compensating the company's independent auditor, subject to shareholder approval, (ii) pre-approving all services of the independent auditor. The audit committee must review and approve all related party transactions and (iii) overseeing our accounting and financial reporting processes and the audits of our financial statements. Our audit committee is also authorized to act as our "qualified legal compliance committee." As such, our audit committee will be 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 material violations of U.S. law by us or any of our agents.

We believe we currently meet the applicable NASDAQ requirements and we intend to continue to take all actions as may be necessary for us to maintain our compliance with applicable NASDAQ requirements.

Compensation Committee

As required by NASDAQ rules, our compensation committee approves the compensation of our executive officers. The compensation of our chief executive officer also requires the approval of our board of directors under the Israeli Companies Law. The compensation committee is also authorized to approve the grant of stock options and other securities to eligible grantees under our benefit plans pursuant to guidelines adopted by our board of directors. However, grants of stock options and other securities to our executive officers also require approval of our board of directors. The current members of this committee, each of whom satisfies the respective independence requirements of NASDAQ, are Dan Falk (chairman), Rimon Ben Shaoul, Yoseph Dauber and Yocheved Dvir.

Nominations Committee

As required by NASDAQ rules, our nominations committee recommends candidates for election to our board of directors pursuant to a written charter. The current members of this committee, all of whom are independent directors, are Ron Gutler and Dan Falk.

Mergers and Acquisitions Committee

Our Board of Directors has delegated powers with respect to the review and recommendation of mergers and acquisitions and related investments and transactions. Our mergers and acquisitions committee provides recommendations to our Board of Directors regarding mergers and acquisitions, which are then subject to approval by the Board of Directors. The committee also has limited authority to approve mergers and acquisitions up to a certain value. The current members of this committee, all of whom are independent directors, are David Kostman (chairman), Ron Gutler, Dan Falk and Rimon Ben Shaoul.

Employees

At December 31, 2011, we had 3,129 employees worldwide, which represented an increase of approximately 12% from year-end 2010.

The following table sets forth the number of our full-time employees at the end of each of the last three fiscal years as well as the main category of activity and geographic location of such employees:

| | At December 31, | | |
|---|---|---|---|
| Category of Activity | 2009 | 2010 | 2011 |
| Operations | 101 | 122 | 147 |
| Customer Support | 966 | 1,018 | 1,204 |
| Sales & Marketing | 530 | 604 | 677 |
| Research & Development | 638 | 705 | 728 |
| General & Administrative | 361 | 345 | 373 |
| Total | 2,596 | 2,794 | 3,129 |
| | | | |
| Geographic Location | | | |
| Israel | 1,086 | 1,212 | 1,200 |
| Americas | 942 | 1,009 | 1,095 |
| Europe | 373 | 352 | 564 |
| Asia Pacific | 195 | 221 | 270 |
| Total | 2,596 | 2,794 | 3,129 |

We also utilize temporary employees in various activities. On average, we employed 47 temporary employees and obtained services from 569 consultants (not included in the numbers set forth above) during 2011.

Our future success will depend in part upon our ability to attract and retain highly skilled and qualified personnel. Although competition for such personnel is generally intense, we believe that adequate personnel resources are currently available in Israel to meet our requirements.

We are not a party to any collective bargaining agreement with our employees or with any labor organization. However, we are subject to certain labor related statutes, and to certain provisions of collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordinating Bureau of Economic Organizations (includ–ing the Industrialists' Association of Israel) that are applicable to our Israeli employ–ees by order of the Israeli Ministry of Labor and Welfare. These statutes and provisions principally concern the length of the work day and the work week, minimum wages for workers, insurance for work-related accidents, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our Israeli employees are automatically adjusted based on changes in the Israeli consumer price index, or CPI. The amount and frequency of these adjustments are modified from time to time. Israeli law generally requires the payment by employers in Israel of severance pay upon the death of an employee, his retirement or upon termination of employment by the employer without due cause. We currently fund our ongoing severance obligations in Israel by making monthly payments to approved severance funds or insurance policies. Please see Note 2q to our Consolidated Financial Statements. In addition, according to the National Insurance Law, Israeli employers and employees are required to pay predetermined sums to the National Insurance Institute, an organization similar to the U.S. Social Security Administration. These contributions entitle the employees to benefits in periods of unemployment, work injury, maternity leave, disability, reserve military service and bankruptcy or winding-up of the employer. Since January 1, 1995, such amount also includes payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 17% of an employee's wages (up to a certain cap as determined from time to time by law), of which the employee contributes approximately 66% and the employer contributes approximately 34%.

In addition to our severance obligations for employees located in Israel, we pay severance benefits to our employees located elsewhere in accordance with the local laws and practices of the countries in which they are employed.

Employment Agreements

We have employment agreements with our officers. Pursuant to these employ–ment agreements, each party may terminate the employment for no cause by giving a 30, 60 or 90 day prior written notice (six months in the case of certain senior officers). In addition, we may terminate such agreement for cause with no prior notice. The agreements generally include non-competition and non-disclosure provisions, although the enforceability of non-competition provisions in employment agreements under Israeli law is very limited.

Share Ownership

As of March 14, 2012, our directors and executive officers beneficially owned an aggregate of 698,285 options to purchase ordinary shares that were vested on such date or that were scheduled to vest within the following 60 days, or approximately 1.14% of our outstanding ordinary shares. The options have an average exercise price of $28.36 per share and expire between 2011 and 2017. The restricted share units are granted at the nominal value of the ordinary shares. No individual director or executive officer beneficially owns 1% or more of our outstanding ordinary shares.

The following is a description of each of our option plans, including the amount of options currently outstanding and the weighted average exercise price.

2008 Share Incentive Plan

In June 2008, we adopted the NICE-Systems Ltd. 2008 Share Incentive Plan, or 2008 Plan, to provide incentives to employees, directors, consultants and/or contractors by rewarding performance and encouraging behavior that will improve our profitability. Under the 2008 Plan, our employees, directors, consultants and/or contractors may be granted any equity-related award, including any type of an option to acquire our ordinary shares and/or share appreciation right and/or share and/or restricted share and/or restricted share unit and/or other share unit and/or other share-based award and/or other right or benefit under the Plan (each an “Award”). We have registered, through the filing of registration statements on Form S-8 with the SEC under the Securities Act of 1933, 5,000,000 ADSs for issuance under the 2008 Plan.

Generally, under the terms of the 2008 Plan, 25% of an Award granted becomes exercisable on the first anniversary of the date of grant and 6.25% becomes exercisable once every quarter during the subsequent three years. Specifically with respect to restricted share units, unless determined otherwise by the board of directors, 25% of the restricted share units granted becomes vested on each of the four consecutive annual anniversaries following the date of grant. Certain executive officers are entitled to acceleration of vesting of awards in the event of a change of control, subject to certain conditions. Awards with a vesting period expire six years after the date of grant. Awards are non-transferable except by will or the laws of descent and distribution.

In December 2010, we amended the 2008 Plan, such that: (i) options are granted at an exercise price equal to the average of the closing prices of one American Depositary Receipts or ADR, as quoted on the NASDAQ market, during the 30 consecutive calendar days preceding the date of grant, unless determined otherwise by the administrator of the 2008 Plan (including in some cases options granted with an exercise price equal to the nominal value of an ordinary share), and (ii) options granted with an exercise price equal to the nominal value of an ordinary share shall have a vesting schedule identical to that of restricted share units, as indicated above.

Our board of directors adopted an addendum to the 2008 Plan for Awards granted to grantees who are residents of Israel (the “Addendum”). On June 16, 2008, our board of directors resolved to elect the “Capital Gains Route” (as defined in Section 102(b)(2) of the Israeli Income Tax Ordinance (the “Tax Ordinance”)) for the grant of Awards to Israeli grantees, which is described above under “1995 Stock Option Plan.” The U.S. addendum of the 2008 Plan provides only for non-qualified stock options for purposes of U.S. tax laws.

The 2008 Plan provides that the number of shares that may be subject to Awards granted under the 2008 Plan shall be an amount per calendar year, equal to 3.5% of our issued and outstanding share capital as of December 31 of the preceding calendar year. Out of such quantity, options that are not granted in a particular calendar year will not be allocated during the next calendar years. By setting these terms, our board of directors took into account the need for current employee retention and retention of future employees, including, specifically, the need to retain in certain years employees that join through acquisitions. During 2010, we granted 1,635,387 options and restricted share units under the 2008 Plan (which constitutes 2.6% of our issued and outstanding share capital as of December 31, 2009).

The 2008 Plan is generally administered by our board of directors and compensation committee, which determines the grantees under the 2008 Plan and the number of Awards to be granted. As of March 14, 2012, options and restricted share units to purchase 4,009,487 ordinary shares were outstanding under the 2008 Plan at a weighted average exercise price of $22.27.

2003 Stock Option Plan

In December 2003, we adopted the NICE-Systems Ltd. 2003 Employee Stock Option Plan, or 2003 Plan, to attract, motivate and retain talented employees by rewarding performance and encouraging behavior that will improve our profitability. Under the 2003 Plan, our employees, officers and directors may be granted options to acquire our ordinary shares. The options to acquire ordinary shares are granted at an exercise price of not less than the fair market value of the ordinary shares on the date of the grant, subject to certain exceptions which may be determined by our board of directors. We have registered, through the filing of registration statements on Form S-8 with the SEC under the Securities Act of 1933, 8,962,112 ADSs for issuance under the 2003 Plan.

Generally, under the terms of the 2003 Plan, 25% of the stock options granted become exercisable on the first anniversary of the date of grant and 6.25% becomes exercisable once every quarter during the subsequent three years. Stock options expire six years after the date of grant. Stock options are non-transferable except upon the death of the grantee. For information regarding options granted under the 2003 Plan to our directors, please see Item 6, “Directors, Senior Management and Employees–Compensation” in this annual report.

Pursuant to the tax reform and in order to comply with the provisions of Section 102 of the Tax Ordinance, on January 5, 2004, our board of directors adopted an addendum to our share option plan with respect to options granted as of December 2, 2003, to grantees who are residents of Israel (the “Addendum”). The Addendum does not add to nor modify our share option plan in respect of grantees that are not residents of Israel. On December 19, 2003, the board of directors resolved to elect the “Capital Gains Route” (as defined in Section 102(b)(2) of the Tax Ordinance) for the grant of options to Israeli grantees. Generally, subject to the fulfillment of the provisions of Section 102 of the Tax Ordinance, under the Capital Gains Route gains realized from the sale of shares issued upon exercise of options will mostly be taxed at a rate of only 25% and partially at the marginal income tax rate applicable to the grantee (up to 48% in 2011). In general, all options granted to Israeli grantees, shares issued upon exercise of such options and any bonus shares issued with respect to such shares will be held in trust for the benefit of the grantee for at least a period of 24 months from the date of grant. The options may not be released from the trust prior to the payment of the grantee’s tax liabilities. In the event the requirements of Section 102 for the allocation of options according to the Capital Gains Route are not met, the applicable marginal income tax rates will apply.

The 2003 Plan provides that the number of ordinary shares reserved for issuance thereunder shall increase each year commencing in 2004 by the lesser of (x) 600,000 ordinary shares or (y) two percent (2%) of the total number of outstanding ordinary shares as of December 31 of the immediately preceding calendar year. On September 28, 2005, our shareholders approved the transfer of ordinary shares reserved for issuance under our ESPP (as defined below) to the 2003 Plan. According to such shareholders' resolution, 1,437,888 ordinary shares remained registered under the ESPP at such time, and the balance of 3,062,112 ordinary shares were transferred to the 2003 Plan, of which 1,062,112 ordinary shares were transferred immediately and an additional 500,000 ordinary shares that were added annually to the pool of ordinary shares were transferred to the 2003 Plan each year until calendar year 2009. In addition, on December 21, 2006, our shareholders approved an increase in the number of ordinary shares reserved for issuance under the 2003 Plan by 1,300,000 shares.

The 2003 Plan is generally administered by our compensation committee, which determines the grantees under the 2003 Plan and the number of options to be granted. As of March 14, 2012, options to purchase 415,724 ordinary shares were outstanding under the 2003 Plan at a weighted average exercise price of $30.91.

1999 Amended and Restated Employee Stock Purchase Plan

In 1999, we adopted the NICE-Systems Ltd. 1999 Employee Stock Purchase Plan, or ESPP, in order to provide an incentive to our employees and the employees of our subsidiaries by providing them with an opportunity to purchase our ordinary shares through accumulated payroll deductions, and thereby enable such persons to share in the future growth of our business. We amended the ESPP in December 2003 and in December 2005. We have registered, through the filing of registration statements on Form S-8 with the SEC under the Securities Act, 1,737,888 ADSs for issuance under the ESPP. For information on the transfer of ordinary shares reserved for issuance under the ESPP to the 2003 Plan, please see the description under the caption "2003 Stock Option Plan" above.

Under the terms of the ESPP, eligible employees (generally, all our employees and the employees of our eligible subsidiaries who are not directors or controlling shareholders) may, on January 1 and July 1 of each year in which the ESPP is in effect, elect to become participants in the ESPP for that six-month period by filing an agreement with us arranging for payroll deductions of between 2% and 10% of such employee's compensation for the relevant period. An employee's election to purchase ordinary shares under the ESPP is subject to his or her right to withdraw from the ESPP prior to exercise, six months after the offering date. The price per ordinary share under the ESPP is 95% of the closing sales price of one ADR as quoted on NASDAQ on the semi-annual purchase date.

Actimize Ltd. 2003 Omnibus Stock Option and Restricted Stock Incentive Plan

Pursuant to the terms of the acquisition of Actimize Ltd. in August 2007, we assumed and replaced the stock options and restricted shares granted by Actimize.

In 2003, Actimize adopted the 2003 Omnibus Stock Option and Restricted Stock Incentive Plan, or the 2003 Actimize Plan, to afford an incentive to employees, officers, office holders, directors, subcontractors and consultants of Actimize or any subsidiary of Actimize, to acquire a proprietary interest in Actimize, to increase their efforts on behalf of Actimize and to provide the success of Actimize's business. Under the 2003 Actimize Plan, the grantees could be granted options to acquire Actimize's ordinary shares, restricted shares and shares. Incentive stock options to acquire ordinary shares of Actimize were granted at an exercise price not less than the fair market value of the ordinary shares of Actimize on the date of grant or as determined by Actimize's board of directors or by a committee thereof. In addition, the options were granted at an exercise price of not less than the par value of the ordinary shares of Actimize.

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

Generally, under the terms of the 2003 Actimize Plan, 25% of the options granted become exercisable on the first anniversary of the date of grant and 6.25% become exercisable following the lapse of every consecutive quarter thereafter during the subsequent three years. Options generally expire ten years after the date of grant. Options are non-transferable except upon the death of the grantee. When applicable, the options are held by, and registered in the name of, a trustee for a period of two years after the date of grant in accordance with Section 102 of the Israeli Income Tax Ordinance.

As of March 14, 2012, options to purchase 91,479 ordinary shares of NICE were outstanding at a weighted average exercise price of $10.64. No additional grants are being made under this plan following the acquisition of Actimize.

Orsus Solutions Limited 2007 Incentive Option Plan

In 2007, Orsus adopted the 2007 Incentive Option Plan that was further amended by Orsus on January 10, 2010 (the "2007 Orsus Plan"), to afford an incentive to employees, office holders and service providers of Orsus and its subsidiaries. Under the 2007 Orsus Plan, the grantees could be granted options to acquire Orsus' ordinary A shares, restricted ordinary A shares or restricted ordinary A share units.

Pursuant to the terms of the Orsus acquisition agreement, we assumed and converted the outstanding stock options and restricted share units granted by Orsus under the Orsus 2007 Plan, into stock options to purchase ordinary shares of NICE or restricted share units of NICE, pursuant to a set formula (the "Assumed Awards"). The Assumed Awards include (i) options or restricted share units granted to certain key employees of Orsus or its subsidiaries (the "Key Employee Awards"); and (ii) retention options granted to certain employees of Orsus or its subsidiaries (the "Retention Options"). Under the terms of the 2007 Orsus Plan and the acquisition agreement, 50% of the Key Employee Awards granted become exercisable and vest after a period of twelve months of continuous employment with NICE (or its applicable subsidiary) commencing on January 11, 2010 and the remaining 50% become exercisable following the lapse of 6 months thereafter. In addition, if employment of a key employee is terminated within a limited time period and under certain circumstances, such key employee's Options shall become vested immediately. The Retention Options vest over a course of four years as follows: (i) 25% vest and become exercisable at the lapse of 12-month period of continuous employment with NICE (or its applicable subsidiary) commencing on January 11, 2010, and (ii) the balance thereof vests on a quarterly basis during the 36 months period thereafter, such that 6.25% vest and become exercisable at the lapse of each quarter of continuous employment with NICE (or its applicable subsidiary). Options generally expire ten years after the date of grant and restricted share units generally expire seven years after the date of grant. Options are non-transferable except upon the death of the grantee. When applicable, the options are held by, and registered in the name of, a trustee for a period of two years after the date of grant in accordance with Section 102 of the Israeli Income Tax Ordinance.



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As of March 14, 2012, options and restricted share units to purchase 31,668 ordinary shares of NICE were outstanding under the 2007 Orsus Plan, comprised of 18,250 ordinary shares underlying the Retention Options at an exercise price per share of $30.78; and 13,418 ordinary shares underlying the Key Employee Awards at an exercise price per share equal to the nominal value of the ordinary shares of NICE. We have registered, through the filing of registration statements on Form S-8 with the SEC under the Securities Act of 1933, 60,000 ADRs for issuance under the 2007 Orsus Plan.

e-Glue Software Technologies Inc., 2004 Stock Option Plan

In 2004, e-Glue adopted the 2004 Stock Option Plan that was further amended by e-Glue on June 9, 2010 (the “2004 e-Glue Plan”), for the grant of awards to employees, directors and service providers of e-Glue and its subsidiaries. The 2004 e-Glue Plan provides for the grant of options to acquire e-Glue’s stock, for the grant of restricted stock and for the grant of restricted share units.

Pursuant to the terms of the e-Glue acquisition agreement, we assumed the outstanding stock options and restricted share units granted by e-Glue under the 2004 e-Glue Plan that did not expire upon closing of the e-Glue acquisition. Following such assumption, the options represent rights to purchase ordinary shares of NICE or restricted share units of NICE, pursuant to a set formula (such options and restricted share units, together the “Assumed e-Glue Options”). Some of the Assumed e-Glue Options have a three year vesting period, with a third becoming vested and exercisable one year from their date of grant and the remainder vesting and become exercisable in equal installments on an annual basis over the following two years. The remaining portion of the Assumed e-Glue Options vest as follows: 25% vest and become exercisable one year from their date of grant, and the remaining 75% vest and become exercisable on December 31, 2011. Certain Assumed e-Glue Options are subject to acceleration rights if employment is terminated within a limited time period and under certain circumstances. If the grantee ceases to be an employee or service provider of us or one of our subsidiaries, for any reason, the optionee may exercise or be entitled to the Assumed e-Glue Options to the extent they were vested and exercisable on the date of termination of employment or service, as the case may be, but only during the period ending on the earlier of (a) 10 years from the date of grant (unless sooner terminated as provided in a specific award agreement) or (b) three months after the date of termination of employment or service, as the case may be. However, if the optionee dies or becomes disabled prior to the expiration date of his or her Assumed e-Glue Options while still in the employ or service of us or one of our subsidiaries, or during the three month period described in the preceding sentence, or in the event of the retirement of the optionee for reasons of disability (within the meaning of Section 22(e)(3) of the U.S. Internal Revenue Code, 1986), the Assumed e-Glue Options shall remain exercisable until the earlier of their expiration date in accordance with the award agreement or one year from the date of such death or retirement. When applicable, the Assumed e-Glue Options shall be held by, and registered in the name of, a trustee, according to Section 102(b) of the Israeli Income Tax Ordinance [New Version], 5731-1961.

As of March 14, 2012, Assumed e-Glue Options and restricted share unit to purchase 55,892 ordinary shares of NICE were outstanding under the 2004 e-Glue Plan. The exercise price per share underlying the options and restricted share units is equal to the nominal value of an ordinary share. We have registered, through the filing of a registration statement on Form S-8 with the SEC under the Securities Act of 1933, 76,035 ADRs for issuance under the 2004 e-Glue Plan.

Fizzback Group (Holdings) Limited Employee Share Option Scheme

In July 2010, Fizzback adopted the Fizzback Group (Holdings) Limited Employee Share Option Scheme, as amended (the "Fizzback Plan"), to grant options to employees, directors and consultants, as applicable, of Fizzback. Under the Fizzback Plan, the grantees could be granted options which are deemed "qualifying options" for the purposes of the EMI Code to acquire Fizzback's ordinary shares, restricted share units and unapproved options.

Pursuant to the terms of the Fizzback share purchase agreement, we replaced the options and restricted share units originally granted under the Fizzback Plan with stock options to purchase ordinary shares of NICE and restricted share units of NICE, respectively.

Under the Fizzback Plan, the exercise price per option shall be determined by the board of directors in its sole and absolute discretion provided that such price shall not be less than the nominal value per option, or (when applicable) such price as from time to time adjusted pursuant to the Fizzback Plan. If a grantee ceases to be an employee, all options which have not become exercisable or which, having become exercisable, have not been exercised, shall lapse.

Options generally expire, inter alia, ten years after the date of grant, upon an insolvent liquidation of Fizzback or upon the grantee being adjudged bankrupt.

As of March 14, 2012, options and restricted share units to purchase 151,969 ordinary shares of NICE were outstanding under the Fizzback Plan. We have registered, through the filing of a registration statement on Form S-8 with the SEC under the Securities Act of 1933, 165,695 ordinary shares for issuance under the Fizzback Plan.

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Merced Plans

Merced Systems, Inc. 2001 Stock Plan

In 2001, Merced adopted the Merced Systems, Inc. 2001 Stock Plan, as amended (the "2001 Merced Plan"), to afford an incentive to employees and consultants of Merced and to promote the success of Merced's business. Under the 2001 Merced Plan, the grantees could be granted options to acquire Merced's ordinary shares and restricted shares.

Pursuant to the terms of the Merced acquisition agreement, we assumed and converted Merced's options and replaced Merced's restricted shares that were originally granted under the 2001 Merced Plan into stock options to purchase ordinary shares of NICE, and with restricted shares of NICE, respectively.

Under the 2001 Merced Plan, the exercise price per share of incentive stock options granted to an employee shall be no less than 100% of the fair market value per share on the date of grant, or 110% of the fair market value if the employee was a 10% shareholder of Merced at the date of grant. The exercise price per share of non-statutory stock options granted shall be no less than 85% of the fair market value per share on the date of grant, or 110% of the fair market value if the person was a 10% shareholder of Merced at the date of grant, if required by applicable law and, if not so required, the exercise price per share shall be determined by the plan administrator. Notwithstanding the foregoing, options may be granted with an exercise price per share other than as required above pursuant to a merger or other corporate transaction.

An option granted under the 2001 Merced Plan is exercisable at the rate of at least 20% per year over five years from the date the option was granted. Options generally expire ten years after the date of grant.

Merced Systems, Inc. 2011 Stock Plan

In 2011, Merced adopted the Merced Systems, Inc. 2011 Stock Plan (the "2011 Merced Plan"), to afford an incentive to employees and consultants of Merced and to promote the success of Merced's business. Under the 2011 Merced Plan, the grantees could be granted options to acquire Merced's ordinary shares and restricted share units.

Pursuant to the terms of the Merced acquisition agreement, we assumed and converted Merced's options and restricted share units originally granted under the 2011 Merced Plan into stock options to purchase ordinary shares of NICE and restricted share units of NICE, respectively.

Under the 2011 Merced Plan, the exercise price per share of incentive stock options granted to an employee shall be no less than 100% of the fair market value per share on the date of grant, or 110% of the fair market value if the employee was a 10% shareholder of Merced at the date of grant. The exercise price per share of non-statutory stock options shall be no less than 85% of the fair market value per share on the date of grant, or 110% of the fair market value if the person was a 10% shareholder of Merced at the date of grant, if required by applicable law and, if not so required, the exercise price per share shall be determined by the plan administrator. Notwithstanding the foregoing, options may be granted with an exercise price per share other than as required above pursuant to a merger or other corporate transaction.

An option granted under the 2011 Merced Plan is exercisable at the rate of at least 20% per year over five years from the date the option was granted. Options generally expire ten years after the date of grant.

As of March 14, 2012, options, restricted share units and restricted shares to purchase 343,288 ordinary shares of NICE were outstanding under the 2001 Merced Plan and the 2011 Merced Plan. We have registered, through the filing of a registration statement on Form S-8 with the SEC under the Securities Act of 1933, 343,288 ordinary shares for issuance under the 2001 Merced Plan and the 2011 Merced Plan.

Option Exchanges and Price Adjustment

On June 23, 2009, we commenced a tender offer to offer eligible employees in Israel, Hong Kong, the United States and the United Kingdom, excluding our directors, Chief Executive Officer and certain other executive officers, the opportunity to tender options granted before September 1, 2008 under the 2003 Plan or the 2003 Actimize Plan (almost all of which had an exercise price per share above $34.00), in exchange for restricted share units (RSUs) or options (depending on the employee's country of residence) with a per share exercise price or per share purchase price equal to the par value of our ordinary shares, or NIS 1.00 (approximately $0.25). The exchange was on a one-for-three basis, meaning that eligible employees electing to participate received a new RSU or option with respect to one share for every three shares subject to the options tendered for exchange. The new awards vest in 25% annual increments over a four-year period starting from August 5, 2009 and have a new six-year term. Options surrendered in the exchange were cancelled. On August 5, 2009, the expiration date of the exchange offer, we accepted for exchange eligible options to purchase an aggregate of 1,492,204 ordinary shares that had been granted under the 2003 Plan and the 2003 Actimize Plan, and granted, under the 2008 Plan, new options to purchase 311,454 ordinary shares, and new RSUs representing 185,932 ordinary shares, in exchange for the eligible options tendered and accepted pursuant to the exchange offer.

On June 15, 2009, our board of directors approved the reduction of the exercise price per share of our options to acquire ordinary shares granted on September 2, 2008 under the 2008 Plan held by eligible employees, including certain of our executive officers, based in Israel, Hong Kong, the United States, and the United Kingdom. The exercise price per share of these options was originally $30.25 per share, and was reduced to $22.53 per share, which was the closing price of our ADSs on the NASDAQ Global Select Market on June 15, 2009. Other than the exercise price, no other terms of these options were modified. The aggregate number of our ordinary shares that are subject to the options that have been repriced is 1,020,400.

In addition, on June 15, 2009, our board of directors approved an option exchange with three of our executive officers, in which such executive officers exchanged options to purchase an aggregate of 265,000 ordinary shares, issued in 2007 under the 2003 Plan and having an exercise price between $34.00 and $39.00 per share, for new options to be issued under the 2008 Plan with a per share exercise price equal to $22.53 per share, which was the closing price of our ADSs on the NASDAQ Global Select Market on June 15, 2009. The new options issued in this exchange vest in four equal annual installments (or as nearly as possible) following the new grant date and will expire six years following the new grant date.

Item 7. Major Shareholders and Related Party Transactions

Major Shareholders

The following table sets forth certain information with respect to the beneficial ownership of our ordinary shares, with respect to each person known to us to be the beneficial owner of 5% or more of our outstanding ordinary shares, reported as of March 2, 2012. None of our shareholders has any different voting rights than any other shareholder.

| Name and Address | Number of Shares | Percent of Shares Beneficially Owned (1) |
|---|---|---|
| Psagot Investment House Ltd.<br>14 Ahad Ha'am Street<br>Tel Aviv 65142, Israel | 3,583,919 (2) | 5.5% |
| Migdal Insurance and Financial Holdings Ltd.<br>4 Efal Street, P.O. Box 3063<br>Petach Tikva 49512, Israel | 3,905,270 (3) | 6.0% |

(1) Based upon 65,026,632 ordinary shares issued and outstanding on March 2, 2012.

(2) These securities are held for members of the public through, among others, portfolio accounts managed by Psagot Securities Ltd., Psagot Exchange Traded Notes Ltd., mutual funds managed by Psagot Mutual Funds Ltd., provident funds managed by Psagot Provident Funds and Pension Ltd., and pension funds managed by Psagot Pension (Haal) Ltd., according to the following segmentation: 1,674,920 ordinary shares are held by portfolio accounts managed by Psagot Securities Ltd., 1,371,825 ordinary shares are held by provident funds managed by Psagot Provident Funds and Pension Ltd., 396,221 ordinary shares are held by Psagot Exchange Traded Notes Ltd., 113,088 ordinary shares are held by mutual funds managed by Psagot Mutual Funds Ltd., and 27,865 ordinary shares are held by pension funds managed by Psagot Pension (Haal) Ltd. Each of the foregoing companies is a wholly-owned subsidiary of Psagot Investment House Ltd. This information is based upon a Schedule 13G/A filed by Psagot Investment House Ltd. with the SEC on February 13, 2012. Ron Gutler, our Chaiman of the Board, serves as a director of Psagot Securities Ltd. and Psagot Investment House Ltd., but disclaims beneficial ownership of the shares held by these entities.

(3) Of which: (i) 3,812,852 ordinary shares are held for members of the public through, among others, provident funds, mutual funds, pension funds and insurance policies, which are managed by subsidiaries of Migdal Insurance and Financing Holdings Ltd., according to the following segmentation: 2,333,564 ordinary shares are held by profit participating life assurance accounts; 1,308,507 ordinary shares are held by provident funds and companies that manage provident funds and 170,781 ordinary shares are held by companies for the management of funds for joint investments in trusteeship, each of which subsidiaries operates under independent management and makes independent voting and investment decisions, and (ii) 92,418 are beneficially held for Migdal Insurance and Financing Holdings Ltd. own account (Nostro account). This information is based upon a Schedule 13G filed by Migdal Insurance and Financing Holdings Ltd. with the SEC on February 14, 2012.

As of March 2, 2012, we had approximately 66 ADS holders of record in the United States, holding approximately 61% of our outstanding ordinary shares, as reported by The Bank of New York Mellon, the depositary for our ADSs.

As of December 31, 2010, The Phoenix Holding Ltd. ("Phoenix") held 3,032,139, or 4.82% of our ordinary shares. This information is based upon a Schedule 13G filed by Phoenix with the SEC on March 1, 2011. Based on the Schedule 13G, Phoenix is an indirect majority-owned subsidiary of Delek Investments and Properties Ltd. ("Delek Investments"). Delek Investments is a wholly-owned subsidiary of Delek Group Ltd. The majority of Delek Group Ltd.'s outstanding share capital and voting rights are owned, directly and indirectly, by Itshak Sharon (Tshuva) through private companies wholly-owned by him, and the remainder is held by the public. As of March 1, 2010, Phoenix and Excellence Investments Ltd. ("Excellence") held 3,479,696, or 5.6% of our ordinary shares. This information is based upon information provided to us by Phoenix and Excellence.

To our knowledge, we are not directly or indirectly owned or controlled by another corporation or by any foreign government and there are no arrangements that might result in a change in control of our company.

Related Party Transactions

None.

Item 8. Financial Information.

Consolidated Statements and Other Financial Information

See Item 18, “Financial Statements.”

Legal Proceedings

We are not involved in any legal proceedings that we believe, individually or in the aggregate, will have a material adverse effect on our business, financial condition or results of operation, except as noted below.

Calyon Dispute

In December 2006, Calyon Corporate and Investment Bank filed a suit against us in the District Court of Tel Aviv, demanding repayment of $648,144 plus accrued interest, for a total amount of $740,395. We had deducted this amount in January 2004 from a payment transferred in connection with our acquisition of Thales Contact Solutions ("TCS"). We had notified TCS in 2004 that we had set off such amount with respect to an overdue payment by TCS to us. The dispute was submitted to mediation, however the mediation process failed and the proceedings were returned to the District Court of Tel Aviv. A trial was held on September 11, 2011. The parties submitted their written summations and now await the Court’s decision.

Actimize Former Employee Dispute

On October 15, 2007, a former employee of Actimize Ltd., a wholly owned subsidiary of ours, filed a claim with the Tel Aviv District Labor Court, seeking a declaration that he is entitled to 0.5% of the outstanding share capital of Actimize Ltd. The preliminary stages of the claim ended and the parties submitted their testimonies by way of written affidavits. The hearing and cross-examination of the testimonies took place on June 16 and June 23, 2010. On July 31, 2011, the court ruled in favor of Actimize, dismissing all claims filed by the former employee and ordering him to pay expenses.

Fair Isaac Patent Infringement Lawsuit

On September 16, 2009 Fair Isaac Corporation (FICO) filed a claim in the United States District Court for the District of Delaware against Actimize Inc., a wholly owned subsidiary of ours, and NICE, claiming that Actimize and NICE are infringing on two U.S. patents. These patents cover various aspects of fraud detection. FICO requested damages and an injunction. On December 17, 2009, the parties agreed to dismiss NICE from the action. On December 21, 2009, Actimize filed a response and counterclaims. On January 25, 2010, Actimize filed an amended response and counterclaims. On January 25, 2011, FICO filed a first amended complaint, adding new allegations of infringement of two additional U.S. patents and allegations of willful infringement. The parties are currently engaged in fact discovery. A ten-day jury trial is scheduled for January 28, 2013. On January 18, 2012, the parties agreed to the terms of settlement proposed by the court; a negotiated written settlement agreement is due to be presented to the court by the parties by April 13, 2012.

Nuvation Dispute

On March 10, 2010, Nuvation Research Corporation (“Nuvation”) filed a lawsuit against us with the Supreme Court of the State of New York. The lawsuit alleges, among others, that we breached a contract with Nuvation and defrauded Nuvation. Nuvation is claiming damages in a total amount of $8 million. On May 3, 2010, we filed an Answer and Counterclaim against Nuvation, denying the allegations and further claiming that we had the right to terminate our contract with Nuvation, and that as a consequence of the termination, we sustained damages in the amount of $5 million. On or about September 19, 2011, the parties reached an agreement in principle to settle the dispute through binding arbitration/mediation. The parties had a one-day arbitration/mediation meeting on March 14, 2012 and are awaiting the arbitrator’s decision.

Tal-Yam Dispute

On July 15, 2010, Tal-Yam Engineering Projects Management and Initiation (“Tal-Yam”) filed a suit against us in the Tel Aviv Magistrate’s Court. The suit alleges a breach of contract due to failure to pay for services rendered to us. Tal-Yam is seeking damages in the amount of approximately NIS 1.0 million and disclosure of certain invoices and related documentation. NICE submitted its statement of defense on October 24, 2010. The parties participated in mediation proceedings that were not successful and pre-trial proceedings are currently taking place.

Discrimination in Employment Dispute

On August 20, 2010, a former employee of IEX Corp., a wholly-owned subsidiary of ours, filed a complaint with the District Court of the Northern District of Illinois, alleging that we, and our subsidiary IEX Corp., engaged in prohibited discrimination in terminating his employment. The case was settled in April 2011, and the matter is no longer pending.

Dividends

Since our initial public offering and listing on the NASDAQ National Market (now the NASDAQ Global Select Market) in 1996, we have not declared or paid cash dividends on our ordinary shares or ADSs. We intend to retain our earnings for future growth and therefore do not anticipate paying any cash dividends in the foreseeable future. Under Israeli law, dividends may be paid only out of profits and other surplus (as defined in the law) as of our most recent financial statements or as accrued over a period of two years, whichever is higher, provided that there is no reasonable concern that the dividend distribution will prevent us from meeting our existing and foreseeable obligations as they come due. Payment of future dividends, if any, will be at the discretion of our board of directors and will depend on various factors, such as our statutory profits, financial condition, operating results and current and anticipated cash needs. In the event cash dividends are declared by us, we may pay such dividends in Israeli currency. Under current Israeli regulations, any cash dividend in Israeli currency paid in respect of ordinary shares purchased by non-residents of Israel with non-Israeli currency may be freely repatriated in such non-Israeli currency, at the rate of exchange prevailing at the time of conversion.

Significant Changes

There are no significant changes that occurred since December 31, 2011, except as otherwise disclosed in this annual report and in the annual consolidated financial statements included in this annual report.

Item 9. The Offer and Listing.

Trading in the ADSs

Our American Depositary Shares, or ADSs, have been quoted on the NASDAQ Stock Market under the symbol "NICEV" from our initial public offering in January 1996 until April 7, 1999, and thereafter under the symbol "NICE." Prior to that time, there was no public market for our ordinary shares in the United States. Each ADS represents one ordinary share. The following table sets forth, for the periods indicated, the high and low reported market (sale) prices for our ADSs.

| | ADSs | |
|---|---|---|
| | High | Low |
| Annual | | |
| 2007 | $ 40.95 | $ 29.04 |
| 2008 | 35.87 | 16.11 |
| 2009 | 33.42 | 18.04 |
| 2010 | 35.20 | 25.10 |
| 2011 | 38.49 | 27.17 |
| | | |
| Quarterly 2010 | | |
| First Quarter | $ 34.30 | $ 28.22 |
| Second Quarter | 33.77 | 25.10 |
| Third Quarter | 31.94 | 25.25 |
| Fourth Quarter | 35.20 | 30.30 |
| | | |
| Quarterly 2011 | | |
| First Quarter | $ 37.35 | $ 32.01 |
| Second Quarter | 38.49 | 32.60 |
| Third Quarter | 37.50 | 27.17 |
| Fourth Quarter | 37.82 | 27.61 |
| | | |
| Quarterly 2012 | | |
| First Quarter (through March 28) | $ 39.95 | $ 33.66 |
| | | |
| Monthly | | |
| September 2011 | $ 32.00 | $ 28.49 |
| October 2011 | 37.82 | 27.61 |
| November 2011 | 36.23 | 31.84 |
| December 2011 | 35.24 | 31.26 |
| January 2012 | 36.35 | 33.66 |
| February 2012 | 36.89 | 33.88 |
| March 2012 (through March 28) | 39.95 | 34.36 |

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On March 28, 2012, the last reported price of our ADSs was $39.72 per ADS.

The Bank of New York Mellon is the depositary for our ADSs. Its address is 1 Wall Street, New York, New York 10286.

Trading in the Ordinary Shares

Our ordinary shares have been listed on the Tel-Aviv Stock Exchange, or TASE, since 1991. Our ordinary shares are not listed on any other stock exchange and have not been publicly traded outside Israel (other than through ADSs as noted above). The table below sets forth the high and low reported market (sale) prices of our ordinary shares (in NIS and dollars) on the TASE. The translation into dollars is based on the daily representative rate of exchange published by the Bank of Israel.

| | Ordinary Shares | | | |
|---|---|---|---|---|
| | High | | Low | |
| | NIS | $ | NIS | $ |
| Annual | | | | |
| 2007 | 162.30 | 41.04 | 117.50 | 29.94 |
| 2008 | 133.80 | 35.54 | 63.00 | 16.72 |
| 2009 | 125.00 | 33.70 | 74.05 | 18.18 |
| 2010 | 129.70 | 34.66 | 97.20 | 25.08 |
| 2011 | 139.00 | 37.45 | 97.25 | 27.12 |
| | | | | |
| Quarterly 2010 | | | | |
| First Quarter | 129.70 | 34.66 | 107.00 | 28.73 |
| Second Quarter | 125.70 | 33.80 | 97.20 | 25.08 |
| Third Quarter | 114.50 | 31.11 | 97.83 | 25.19 |
| Fourth Quarter | 125.50 | 35.25 | 109.50 | 29.98 |
| | | | | |
| Quarterly 2011 | | | | |
| First Quarter | 131.50 | 37.45 | 114.50 | 32.12 |
| Second Quarter | 131.70 | 38.68 | 110.50 | 32.18 |
| Third Quarter | 139.00 | 37.45 | 97.25 | 27.12 |
| Fourth Quarter | 135.10 | 37.32 | 105.30 | 27.98 |
| | | | | |
| Quarterly 2012 | | | | |
| First Quarter (through March 28) | 148.90 | 40.08 | 127.70 | 34.00 |
| | | | | |
| Monthly | | | | |
| September 2011 | 139.00 | 37.45 | 102.80 | 28.30 |
| October 2011 | 135.10 | 37.32 | 105.30 | 27.98 |
| November 2011 | 132.50 | 35.56 | 118.00 | 31.62 |
| December 2011 | 134.10 | 35.33 | 119.10 | 31.37 |
| January 2012 | 136.10 | 36.38 | 128.80 | 33.46 |
| February 2012 | 140.70 | 37.68 | 127.70 | 34.00 |
| March 2012 (through March 28) | 148.90 | 40.08 | 128.80 | 34.03 |

As of March 28, 2012, the last reported price of our ordinary shares on the TASE was NIS 148.40 (or $39.85) per share.

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Item 10. Additional Information.

Memorandum and Articles of Association

Organization and Register

We are a company limited by shares organized in the State of Israel under the Israeli Companies Law. We are registered with the Registrar of Companies of the State of Israel and have been assigned company number 52-0036872.

Objectives and Purposes

Our objectives and purposes include a wide variety of business purposes, including all kinds of research, development, manufacture, distribution, service and maintenance of products in all fields of technology and engineering and to engage in any other kind of business or commercial activity. Our objectives and purposes are set forth in detail in Section 2 of our memorandum of association.

Directors

Our articles of association provide that the number of directors serving on the board shall be not less than three but shall not exceed thirteen, including at least two outside directors. Our directors, other than outside directors, are elected at the annual shareholders meeting to serve until the next annual meeting or until their earlier death, resignation, bankruptcy, incapacity or removal by resolution of the general shareholders meeting. Directors may be re-elected at each annual shareholders meeting. The board may appoint additional directors (whether to fill a vacancy or create new directorship) to serve until the next annual shareholders meeting, provided, however, that the board shall have no obligation to fill any vacancy unless the number of directors is less than three. Our officers serve at the discretion of the board.

The board of directors may meet and adjourn its meetings according to the Company's needs but at least once every three months. A meeting of the board may be called at the request of any two directors. The quorum required for a meeting of the board consists of a majority of directors who are lawfully entitled to participate in the meeting and vote thereon. The adoption of a resolution by the board requires approval by a simple majority of the directors present at a meeting in which such resolution is proposed. In lieu of a board meeting, a resolution may be adopted if all of the directors lawfully entitled to vote thereon consent not to convene a meeting.

Subject to the Israeli Companies law, the board may appoint a committee of the board and delegate to such committee all or any of the powers of the board, as it deems appropriate. Under the Israeli Companies Law the board of directors must appoint an internal audit committee, comprised of at least three directors and including both of the outside directors. The function of the internal audit committee is to review irregularities in the management of the Company's business and recommend remedial measures. The committee is also required, under the Israeli Companies Law, to approve certain related party transactions and to assess our internal audit system and the performance of our internal auditor. Notwithstanding the foregoing, the board may, at any time, amend, restate or cancel the delegation of any of its powers to any of its committees. The board has appointed an internal audit committee which has three members, an audit committee which has four members, a compensation committee which has four members and a mergers and acquisitions committee which has four members. For more information on the Company's committees, please see Item 6, "Directors, Senior Management and Employees—Board Practices" in this annual report.

Fiduciary Duties of Officers

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding exploiting any business opportunity of the company in order to receive personal advantage for himself or others, and revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder.

Approval of Certain Transactions

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors, or controlling parties, require approval of the internal audit committee and the board of directors. Similarly, adoption and amendment of equity based compensation plans require approval of the board of directors. Arrangements regarding the compensation of directors require approval of the internal audit committee, the board of directors and the shareholders, in that order. Although NASDAQ rules generally require shareholder approval when an equity based compensation plan is established or materially amended, as a foreign company we follow the aforementioned requirements of the Israeli Companies Law.

The Israeli Companies Law requires that an office holder of the company promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction as defined under Israeli law, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandpar–ents, descendants, spouse's descendants and the spouses of any of the foregoing. In addition, the office holder must also disclose any interest held by any corporation in which the office holder is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company's profitability, assets or liabilities.

In the case of a transaction which is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, only board approval is required unless the articles of association of the company provide otherwise. The transaction must not be adverse to the company's interest. Furthermore, if the transaction is an extraordinary transaction, then, in addition to any approval stipulated by the articles of association, it also must be approved by the company's internal audit committee and then by the board of directors, and, under certain circumstances, by a meeting of the shareholders of the company. An office holder who has a personal interest in a transaction that is considered at a meeting of the board of directors or the internal audit committee generally may not be present at the deliberations or vote on this matter, unless the chairman of the board or chairman of the internal audit committee, as the case may be, determined that the presence of such person is necessary to present the transaction to the meeting. If a majority of the directors have a personal interest in an extraordinary transaction with the Company, shareholder approval of the transaction is required.

The Israeli Companies Law applies the same disclosure requirements to a controlling share−holder of a public company, which includes a shareholder that holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Extraor−dinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the terms of management fees of a controlling shareholder or compensation of a controlling shareholder who is an office holder, require the approval of the audit committee, the board of directors and the shareholders of the company by simple majority, provided that either such majority vote must include at least a simple majority of the shareholders who have no personal interest in the transaction and are present at the meeting (without taking into account the votes of the abstaining shareholders), or that the total shareholdings of those who have no personal interest in the transaction who vote against the transaction represent no more than two percent of the voting rights in the company. Any such extraordinary transaction whose term is longer than three years requires further shareholder approval every three years, unless (with respect to transactions not involving management fees or employment terms) the internal audit committee approves that a longer term is reasonable under the circumstances.

In addition, under the Israeli Companies Law, a private placement of securities requires approval by the board of directors and the shareholders of the company if it will cause a person to become a controlling shareholder or if:

- the securities issued amount to twenty percent or more of the company's outstanding voting rights before the issuance;

- some or all of the consideration is other than cash or listed securities or the transaction is not on market terms; and

- the transaction will increase the relative holdings of a shareholder that holds five percent or more of the company's outstanding share capital or voting rights or that will cause any person to become, as a result of the issuance, a holder of more than five percent of the company's outstanding share capital or voting rights.

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According to the Company's articles of association certain resolutions, such as resolutions regarding mergers, and windings up, require approval of the holders of 75% of the shares represented at the meeting and voting thereon.

Duties of Shareholders

Under the Israeli Companies Law, a shareholder has a duty to act in good faith towards the Company and other shareholders and to refrain from abusing his or her power in the company including, among other things, voting in a 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 interested party transactions which require shareholder approval.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who, pursuant to the provisions of a company's articles of association, has the power to appoint or prevent the appointment of an office holder in the company, is under a duty to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty but provides that a breach of his duty is tantamount to a breach of fiduciary duty of an officer of the Company.

Exemption, Insurance and Indemnification of Directors and Officers

We provide our directors with indemnification letters whereby we agree to indemnify them to the fullest extent permitted by law. On September 19, 2011, at our 2011 annual general meeting of shareholders, after the approval of the Audit Committee and the Board, our shareholders approved a modified form of indemnification letter to ensure that our directors are afforded protection to the fullest extent permitted by law.

Exemption of Office Holders

Under the Israeli Companies Law, an Israeli company may not exempt an office holder from liability for breach of his duty of loyalty, but may exempt in advance an office holder from 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 of association do not allow us to do so.

Office Holder Insurance

Our articles of association provide that, subject to the provisions of the Israeli Companies Law, including the receipt of all approvals as required therein or under any applicable law, we may enter into an agreement to insure an office holder for any responsibility or liability that may be imposed on such office holder in connection with an act performed by such office holder in such office holder's capacity as an office holder of us with respect to each of the following:

- a violation 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 grounds to assume that his act would not prejudice our interests,
- a financial obligation imposed upon him for the benefit of another person,
- a payment which the office holder is obligated to make to an injured party as set forth in Section 52(54)(a)(1)(a) of the Israeli Securities Law, 5728-1968, as amended (the "Securities Law") and Litigation Expenses (as defined below) that the office holder incurred in connection with a proceeding under Chapters H'3, H'4 or I'1 of the Securities Law, and
- any other event, occurrence or circumstance in respect of which we may lawfully insure an office holder.

Indemnification of Office Holders

Our articles of association provide that, subject to the provisions of the Israeli Companies Law, including the receipt of all approvals as required therein or under any applicable law we may indemnify an office holder with respect to any liability or expense for which indemnification may be provided under the Companies Law, including the following liabilities and expenses, provided that such liabilities or expenses were imposed upon or incurred by such office holder in such office holder's capacity as an office holder of us:

- a monetary liability imposed on or incurred by an office holder pursuant to a judgment in favor of another person, including a judgment imposed on such office holder in a settlement or in an arbitration decision that was approved by a court of law;
- reasonable Litigation Expenses, 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 (mens rea) or in connection with a financial sanction;

- "conclusion of a proceeding without filing an indictment" in a matter in which a criminal investigation has been instigated and "financial liability in lieu of a criminal proceeding," have the meaning ascribed to them under the Israeli Companies Law. The term "Litigation Expenses" shall include, without limitation, attorneys' fees and all other costs, expenses and obligations paid or incurred by an office holder in connection with investigating, defending, being a witness or participating in (including on appeal), or preparing to defend, be a witness or participate in any claim or proceeding relating to any matter for which indemnification may be provided;

- reasonable Litigation Expenses, which the office holder incurred or with which the office holder was charged by a court of law, in a proceeding brought against the office holder, by the Company, on its behalf or by another person, or in a criminal prosecution in which the office holder was acquitted, or in a criminal prosecution in which the office holder was convicted of an offense that does not require proof of criminal intent (mens rea);

- a payment which the office holder is obligated to make to an injured party as set forth in Section 52(54)(a)(1)(a) of the Securities Law, and Litigation Expenses that the office holder incurred in connection with a proceeding under Chapters H'3, H'4 or I'1 of the Securities Law; and

- any other event, occurrence or circumstance in respect of which we may lawfully indemnify an office holder.

The foregoing indemnification may be procured by us (a) retroactively and (b) as a commitment in advance to indemnify an office holder, provided that, in respect of the first bullet above, such commitment shall be limited to (A) such events that in the opinion of the Board of Directors are foreseeable in light of our actual operations at the time the undertaking to indemnify is provided, and (B) to the amounts or criterion that the Board of Directors deems reasonable under the circumstances, and further provided that such events and amounts or criterion are set forth in the undertaking to indemnify, and which shall in no event exceed, in the aggregate, the greater of: (i) twenty five percent (25%) of our shareholder's equity at the time of the indemnification, or (ii) twenty five percent (25%) of our shareholder's equity at the end of fiscal year of 2010.

We have undertaken to indemnify our directors and officers pursuant to applicable law. We have obtained directors' and officers' liability insurance for the benefit of our directors and officers.

Limitations on Exemption, Insurance and Indemnification

The Israeli Companies Law provides that a company may not exempt 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 insurance coverage or indemnification, 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 (other than if solely done in negligence);
- any act or omission done with the intent to derive an illegal personal benefit; or
- a fine, civil fine or ransom levied on an Office Holder, or a financial sanction imposed upon an Office Holder under Israeli Law.

Required Approvals

In addition, under the Israeli Companies Law, any exemption of, indemnification of, or 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 obtained such approvals for the procurement of liability insurance covering our officers and directors and for the grant of indemnification letters to our officers and directors.

Rights of Ordinary Shares

Our ordinary shares confer upon our shareholders the right to receive notices of, and to attend, shareholder meetings, the right to one vote per Ordinary Share at all shareholders' meetings for all purposes, and to share equally, on a per share basis, in such dividends as may be declared by our board of directors; and upon liquidation or dissolution, the right to participate in the distribution of any surplus assets of the Company legally available for distribution to shareholders after payment of all debts and other liabilities of the Company.  All ordinary shares rank pari passu in all respects with each other.  Our board of directors may, from time to time, make such calls as it may think fit upon a shareholder in respect of any sum unpaid in respect of shares held by such shareholder which is not payable at a fixed time, and each shareholder shall pay the amount of every call so made upon him (and of each installment thereof if the same is payable in installments).

Meetings of Shareholders

An annual general meeting of our shareholders shall be held once in every calendar year at such time and at such place either within or without the State of Israel as may be determined by our board of directors.

Our board of directors may, whenever it thinks fit, convene a special general meeting at such time and place, within or without the State of Israel, as may be determined by the board of directors.  Special general meetings may also be convened upon shareholder request in accordance with the Israeli Companies Law and our articles of association.

The quorum required for a 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. Although NASDAQ generally requires a quorum of 33-1/3%, we have an exception under the NASDAQ rules and follow the generally accepted business practice for companies in Israel, which have a quorum requirement of 25%. 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 a majority of the voting power represented at the meeting and voting on the matter adjourned. At such reconvened meeting the required quorum consists of any two members present in person or by proxy.

Mergers and Acquisitions

A merger of the Company shall require the approval of the holders of a majority of seventy five percent (75%) of the voting power represented at the annual or special general meeting in person or by proxy or by written ballot, as shall be permitted, and voting thereon in accordance with the provisions of the Israeli Companies Law. 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 the requisite proposal for 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 Israeli Companies Law also provides that 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 25% or greater shareholder of the company and there is no existing 25% or greater shareholder in the company. 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 greater shareholder of the company and there is no existing 45% or greater shareholder in the company. These requirements do not apply if the acquisition (i) occurs in the context of a private placement by the company 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 offerer 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 offerer 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 acquisition must 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 six months following the consummation of a full tender offer, but the acquirer is entitled to stipulate that tendering shareholders forfeit their appraisal rights. 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.

Material Contracts

Orsus Acquisition

On January 11, 2010, we completed the acquisition of Orsus, a leading provider of Security Management Solutions. The acquisition was for total consideration of approximately $21.5 million, subject to certain adjustments. Orsus` flagship solution, Situator, provides a framework for fusing data silos from disparate security and safety systems as well as multiple command and control centers, into a single, holistic operational view and automating security procedures.

e-Glue Acquisition

On July 15, 2010, we completed the acquisition of e-Glue, a leading provider of real-time decisioning and guidance solutions. The acquisition was for total consideration of approximately $31.4, comprised of $25.6 million in cash and $5.8 million representing the fair value of earn out based on performance milestones amounting to additional payment of $6 million.

CyberTech Acquisition

On March 4, 2011, we completed the acquisition of CyberTech Investments (“CyberTech”), a global provider of compliance recording solutions and value-added applications. We acquired CyberTech for a total cash consideration of approximately $59.4 million. The addition of CyberTech solutions to the NICE portfolio broadens our offering for financial institutions, strengthen our commitment to the small and medium size business sector, and add to our public safety solutions.

Fizzback Acquisition

On October 26, 2011, we completed the acquisition of Fizzback Group (Holdings) Ltd. ("Fizzback"), a global provider of Voice of the Customer (VoC) solutions, providing software solutions for real-time customer feedback that drive customer loyalty and employee performance. The Fizzback solution helps companies listen, respond and act in real-time to their customers’ comments. We acquired Fizzback for a total consideration of approximately $80.9 million. The combination of Fizzback and NICE will both improve Customer Experience Management (CEM) as well as operationalize VoC both for the contact center and across the enterprise.

Merced Acquisition

On February 7, 2012, we completed the acquisition of Merced Systems, Inc. ("Merced"), the leading provider of performance management solutions that drive business execution in sales and service functions. We acquired Merced for total consideration of approximately $150 million, net of cash acquired (approximately $22 million). Additionally, we will pay Merced up to $20 million in cash subject to Merced meeting certain performance targets. Merced's performance management solutions help drive sales effectiveness, superior customer experience and operating efficiency across a range of vertical industries. Merced's products serve Global 2000 customers, and include advanced analytics and reporting, incentive compensation management, coaching, and other performance execution applications. Integrating Merced and NICE capabilities creates a closed-loop performance management solution.

Exchange Controls

Holders of ADSs are able to convert dividends and liquidation distributions into freely repatriable non-Israeli currencies at the rate of exchange prevailing at the time of repatriation, pursuant to regulations issued under the Currency Control Law, 5738–1978, provided that Israeli income tax has been withheld by us with respect to amounts that are being repatriated to the extent applicable or an exemption has been obtained.

Our ADSs may be freely held and traded pursuant to the General Permit and the Currency Control Law. The ownership or voting of ADSs by non-residents of Israel, except with respect to citizens of countries that are in a state of war with Israel, are not restricted in any way by the our memorandum of association or articles of association or by the laws of the State of Israel.

Taxation

The following is a discussion of Israeli and United States tax consequences material to our shareholders. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

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

Israeli Tax Considerations

The following is a summary of the principal tax laws applicable to companies in Israel, with special reference to their effect on us. The following also contains a discussion of the material Israeli tax consequences to purchasers of our ordinary shares or ADSs. This summary does not discuss all the aspects of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the appropriate tax authorities or the courts. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Structure

Generally, Israeli companies are subject to Corporate Tax on taxable income at the rate of 24% for the 2011 tax year and 25% for the 2012 tax year. Following an amendment to the Israeli Income Tax Ordinance [New Version], 1961 (the "Tax Ordinance"), which came into effect on January 1, 2012, the corporate tax rate is scheduled to remain at a rate of 25% for future tax years. Israeli companies are generally subject to capital gains tax at the corporate tax rate. However, the effective tax rate payable by a company that derives income from an Approved or Privileged Enterprise may be considerably less.

In 2011, we elected to measure our Israeli taxable income in U.S. dollars. We were permitted to make such a change pursuant to regulations published by the Israeli Minister of Finance, which provide the conditions for doing so. We believe that we meet and will continue to meet, the necessary conditions and as such, will continue to measure our results for tax purposes based on the U.S. dollar/NIS exchange rate.

Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959, as amended.

We derive and expect to continue to derive significant tax benefits in Israel relating to our "Approved and Privileged Enterprise" programs, pursuant to the Law for Encouragement of Capital Investments, 1959, or the Investments Law. To be eligible for these tax benefits, we must continue to meet certain conditions, including making certain specified investments in fixed assets. In the event of a failure to comply with these conditions, the benefits may be canceled and we may be required to refund the amount of the benefits, in whole or in part, including interest and certain inflation adjustments. As of December 31, 2011 we believe that we are in compliance with all the conditions required by the law.

Full details regarding our Approved and Privileged Enterprises may be found in Note 13(a)(2) of our Consolidated Financial Statements.

Other than by way of our complete liquidation, if we distribute dividends from the income of our "Approved Enterprises" which was exempted from taxes pursuant to our "Approved Enterprise" benefits, we will be taxed as if the exempt income was subject to the regular reduced corporate tax rate arising under our "Approved Enterprise" programs. Tax-exempt income generated under our Privileged Enterprises, will subject the Company to taxes upon dividend distribution (which includes the repurchase of our shares) or complete liquidation.

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

Income from sources other than the “Approved or Privileged Enterprises” during the period of benefits will be taxable at regular corporate tax rates.

Reform of the Investments Law

On December 29, 2010, the Israeli parliament approved an amendment to the Investments Law, effective as of January 1, 2011, which constitutes a reform of the incentives regime under such law. This amendment revises the objectives of the Investments Law to focus on achieving enhanced growth in the business sector, improving the Israeli industry’s competitiveness in international markets and creating employment and development opportunities in remote areas of Israel. The amendment allows enterprises meeting certain required criteria to enjoy grants as well as tax benefits. The amendment also introduces certain changes to the map of geographic development areas for purposes of the Investments Law, which will take effect in future years.

The amendment generally abolishes the previous tax benefit routes that were afforded under the Investment Law, specifically the tax-exemption periods previously allowed, and introduces new tax benefits for industrial enterprises meeting the criteria of the law, which include the following:

- A reduced corporate tax rate for industrial enterprises, provided that more than 25% of their annual income is derived from export, which will apply to the enterprise’s entire preferred income so that in the tax years 2011-2012 the reduced tax rate will be 10% for preferred income derived from industrial facilities located in development area A and 15% for those located elsewhere in Israel, in the tax years 2013-2014 the reduced tax rate will be 7% for development area A and 12.5% for the rest of Israel, and in the tax year 2015 and onwards the reduced tax rate will be 6% for development area A and 12% for the rest of Israel.

- The reduced tax rates will no longer be contingent upon making a minimum qualifying investment in productive assets.

- A definition of “preferred income” was introduced into the Investments Law to include certain types of income that are generated by the Israeli production activity of a preferred enterprise.

- A reduced dividend withholding tax rate of 15% will apply to dividends paid from preferred income to both Israeli and non-Israeli investors, with an exemption from such withholding tax applying to dividends paid to an Israeli company.

- A special tax benefits route will be granted to certain industrial enterprises entitling them to a reduced tax rate of 5% for preferred income derived from industrial facilities located in development area A and 8% for those located elsewhere in Israel, provided certain threshold requirements are met and such enterprise can demonstrate its significant contribution to Israel’s economy and promotion of national market objectives.

A Preferred Company (as defined in the Investments Law) may generally elect to apply the provisions of the amendment to preferred income produced or generated by it commencing from January 1, 2011. The amendment provides various transitional provisions which allow, under certain circumstances, to apply the new regime to investment programs previously approved or elected under the Investments Law in its previous form, or to continue existing investment programs under the provisions of the Investment Law in its previous form for a certain period of time. We believe that the transitional provisions will apply to us such that the earliest date for adoption of the amendment will be January 1, 2012.

Tax Benefits and Grants for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, for the year in which they are incurred. These expenses must relate to scientific research and development projects and must be approved by the relevant Israeli government ministry, determined by the field of research, and the research and development must be for the promotion of the company and carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

Tax Benefits Under the Law for the Encouragement of Industry (Taxes), 1969

Under the Law for the Encouragement of Industry (Taxes), 1969 (the "Industry Encouragement Law"), Industrial Companies (as defined below) are entitled to the following tax benefits, among others:

- deductions over an eight-year period for purchases of know-how and patents;
- deductions over a three-year period of expenses involved with the issuance and listing of shares on a stock market;
- the right to elect, under specified conditions, to file a consolidated tax return with other related Israeli Industrial Companies; and
- accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the Industry Encouragement Law, an "Industrial Company" is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is defined as an enterprise whose major activity in a given tax year is industrial production activity. We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. No assurance can be given that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Israeli Transfer Pricing Regulations

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Tax Ordinance, came into force (the “Transfer Pricing Regulations”). Section 85A of the Tax Ordinance and the Transfer Pricing Regulations generally require that all cross-border transactions carried out between related parties will be conducted on an arm’s length principle basis and will be taxed accordingly. As the Transfer Pricing Regulations are broadly similar to transfer pricing regimes already in place in other jurisdictions in which we operate outside of Israel, we do not expect the Transfer Pricing Regulations to have a material impact on the Company.

Capital Gains Tax on Sales of Our Ordinary Shares

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 both residents and 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 a portion of the total capital gain, which is equivalent to the increase of the relevant asset’s purchase price, which is attributable to the increase in the Israeli consumer price index, or 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.

The following discussion refers to the sale of our ordinary shares. However, the same tax treatment would apply to the sale of our ADSs.

Taxation of Israeli Residents

As of January 1, 2012, the tax rate generally applicable to the capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% for Israeli individuals, unless 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 jointly with others, at least 10% of any means of control in the company) the tax rate will be 30%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of listed shares. However, different tax rates may apply to dealers in securities and shareholders who acquired their shares prior to an initial public offering.

The tax basis of our shares acquired prior to January 1, 2003, will generally be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Taxation of Non-Israeli Residents

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 did not derive from a permanent establishment of such shareholders in Israel. Non-Israeli residents are also exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock market outside of Israel, provided such shareholders did not acquire their shares prior to the issuer's initial public offering (in which case a partial exemption may be available), that the gains did not derive from a permanent establishment of such shareholders in Israel. However, non-Israeli corporations will not be entitled to such exemption if Israeli residents (i) have a controlling interest of 25% or more in such non-Israeli corporation, or (ii) are the beneficiaries of or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In addition, the sale, exchange or disposition of our ordinary shares by a shareholder who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) and who holds ordinary shares as a capital asset is also exempt from Israeli capital gains tax under the U.S.-Israel Tax Treaty unless either (i) the shareholder holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale or (ii) the capital gains arising from such sale are attributable to a permanent establishment of the shareholder located in Israel. If the above conditions are not met, the U.S. resident would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, the gain would be treated as foreign source income for United States foreign tax credit purposes and such U.S. resident would be permitted to claim a credit for such taxes against the United States federal income tax imposed on such sale, exchange or disposition, subject to the limitations under the United States federal income tax laws applicable to foreign tax credits.

Taxation of Dividends Paid on our Ordinary Shares

The following discussion refers to dividends paid on our ordinary shares. However, the same tax treatment would apply to dividends paid on our ADSs.

Taxation of Israeli Residents

Israeli resident individuals are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares, other than bonus shares (share dividends) or stock dividends. As of January 1, 2012, the tax rate applicable to such dividends is 25% or 30% for a shareholder that is considered a significant shareholder at any time during the 12-month period preceding such distribution. Dividends paid from income derived from our Approved or Privileged Enterprises are subject to withholding at the rate of 15%, although we cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability.

Taxation of Non-Israeli Residents

Non-residents of Israel, both companies and individuals, are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares, at the aforementioned rates applicable to Israeli residents, which tax will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence.

Under the U.S.-Israel Treaty, the maximum Israeli withholding tax on dividends paid by us is 25%. Dividends of an Israeli company distributed from income of an Approved Enterprise (or Privileged Enterprise) are subject to a 15% withholding tax under the U.S.-Israel Tax Treaty. The U.S.-Israel Tax Treaty further provides for a 12.5% Israeli dividend withholding tax on dividends paid by an Israeli company to a United States corporation owning at least 10% or more of such Israeli company's issued voting power for, in general, the part of the tax year which precedes the date of payment of the dividend and the entire preceding tax year. The lower 12.5% rate applies only to dividends from income not derived from an Approved Enterprise (or Privileged Enterprise) in the applicable period and does not apply if the company has more than 25% of its gross income derived from certain types of passive income. Residents of the United States generally will have withholding tax in Israel deducted at source. They may be entitled to a credit or deduction for United States federal income tax purposes in the amount of the taxes withheld, subject to detailed rules contained in United States tax legislation.

A non-resident of Israel who has dividend income derived from or accrued in Israel, from which tax was withheld at source, is generally exempt from the duty to file tax returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

U.S. Federal Income Tax Considerations

The following is a summary of the material U.S. Federal income tax consequences that apply to U.S. holders (defined below) who hold ADSs as capital assets for tax purposes. This summary is based on the U.S. Internal Revenue Code of 1986, as amended (the "Code"), existing final, temporary and proposed regulations thereunder, judicial decisions and published positions of the Internal Revenue Service and the U.S.-Israel income tax treaty in effect as of the date of this annual report, all of which are subject to change at any time (including changes in interpretation), possibly with retroactive effect. It is also based in part on representations by The Bank of New York Mellon, the depositary for our ADSs, and assumes that each obligation under the Deposit Agreement between us and The Bank of New York Mellon and any related agreement will be performed in accordance with its terms. This summary does not address all U.S. Federal income tax matters that may be relevant to a particular prospective holder or all tax considerations that may be relevant with respect to an investment in ADSs.

This summary does not address tax considerations applicable to a holder of an ADS that may be subject to special tax rules including, without limitation, the following:

- dealers or traders in securities, currencies or notional principal contracts;
- financial institutions;
- insurance companies;
- real estate investment trusts;
- banks;

- investors subject to the alternative minimum tax;
- tax-exempt organizations;
- regulated investment companies;
- investors that actually or constructively own 10 percent or more of our voting shares;
- investors that will hold the ADSs as part of a hedging or conversion transaction or as a position in a straddle or a part of a synthetic security or other integrated transaction for U.S. Federal income tax purposes;
- investors that are treated as partnerships or other pass through entities for U.S. Federal income tax purposes and persons who hold the ADSs through partnerships or other pass through entities; and
- investors whose functional currency is not the U.S. dollar.

This summary does not address the effect of any U.S. Federal taxation other than U.S. Federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation or the indirect effects on the holders of equity interests in a holder of an ADS.

You are urged to consult your own tax advisor regarding the foreign and U.S. Federal, state and local and other tax consequences of an investment in ADSs.

For purposes of this summary, a "U.S. holder" is a beneficial owner of ADSs that is, for U.S. Federal income tax purposes:

- an individual who is a citizen or a resident of the United States;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate whose income is subject to U.S. Federal income tax regardless of its source; or
- a trust if:

(a) a court within the United States is able to exercise primary supervision over administration of the trust; and

(b) one or more United States persons have the authority to control all substantial decisions of the trust.

If an entity that is classified as a partnership for U.S. federal tax purposes holds ADSs, the U.S. federal income tax treatment of its partners will generally depend upon the status of the partners and the activities of the partnership. Entities that are classified as partnerships for U.S. federal tax purposes and persons holding ADSs through such entities should consult their own tax advisors.

In general, if you hold ADSs, you will be treated as the holder of the underlying shares represented by those ADSs for U.S. Federal income tax purposes. Accordingly, no gain or loss will be recognized if you exchange ADSs for the underlying shares represented by those ADSs.

The U.S. Treasury has expressed concerns that parties to whom ADSs are released may be taking actions that are inconsistent with the claiming of foreign tax credits for U.S. holders of ADSs. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate U.S. holders. Accordingly, the analysis of the creditability of Israeli taxes and the availability of the reduced tax rate for dividends received by certain non-corporate U.S. holders, each described below, could be affected by actions taken by parties to whom the ADSs are released.

U.S. Taxation of ADSs

Distributions

Subject to the discussion under “Passive Foreign Investment Companies” below, the gross amount of any distribution, including the amount of any Israeli taxes withheld from these distributions (see “Israeli Tax Considerations”), actually or constructively received by a U.S. holder with respect to ADSs will be taxable to the U.S. holder as a dividend to the extent of our current and accumulated earnings and profits as determined under U.S. Federal income tax principles. Distributions in excess of earnings and profits will be non-taxable to the U.S. holder to the extent of, and will be applied against and reduce, the U.S. holder’s adjusted tax basis in the ADSs. Distributions in excess of earnings and profits and such adjusted tax basis will generally be taxable to the U.S. holder as capital gain from the sale or exchange of property. We do not maintain calculations of our earnings and profits under U.S. Federal income tax principles. If we do not report to a U.S. holder the portion of a distribution that exceeds earnings and profits, the distribution will generally be taxable as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above. The amount of any distribution of property other than cash will be the fair market value of that property on the date of distribution. The U.S. holder will not, except as provided by Section 245 of the Code, be eligible for any dividends received deduction in respect of the dividend otherwise allowable to corporations.

Under the Code, certain dividends received by non-corporate U.S. holders will be subject to a maximum income tax rate of 15%. This reduced income tax rate is only applicable to dividends paid by a “qualified foreign corporation” that is not a “passive foreign investment company” and only with respect to shares held by a qualified U.S. holder (i.e., a non-corporate holder) for a minimum holding period (generally 61 days during the 121-day period beginning 60 days before the ex-dividend date). We should be considered a qualified foreign corporation because (i) we are eligible for the benefits of a comprehensive tax treaty between Israel and the U.S., which includes an exchange of information program, and (ii) the ADSs are readily tradable on an established securities market in the U.S. In addition, based on our current business plans, we do not expect to be classified as a “passive foreign investment company” (see “Passive Foreign Investment Companies” below). Accordingly, dividends paid by us to individual U.S. holders on shares held for the minimum holding period should be eligible for the reduced income tax rate. The reduced tax rate for qualified dividends generally is scheduled to expire on December 31, 2012, unless further extended by Congress.

The amount of any distribution paid in a currency other than U.S. dollars (a "foreign currency") including the amount of any withholding tax thereon, will be included in the gross income of a U.S. holder in an amount equal to the U.S. dollar value of the foreign currencies calculated by reference to the exchange rate in effect on the date of receipt, regardless of whether the foreign currencies are converted into U.S. dollars. If the foreign currencies are converted into U.S. dollars on the date of receipt, a U.S. holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend. If the foreign currencies received in the distribution are not converted into U.S. dollars on the date of receipt, a U.S. holder will have a basis in the foreign currencies equal to its U.S. dollar value on the date of receipt. Any gain or loss on a subsequent conversion or other disposition of the foreign currencies will be treated as ordinary income or loss.

Dividends received by a U.S. holder with respect to ADSs will be treated as foreign source income for the purposes of calculating that holder's foreign tax credit limitation. Subject to certain conditions and limitations, any Israeli taxes withheld on dividends at the rate provided by the U.S.-Israel income tax treaty may be deducted from taxable income or credited against a U.S. holder's U.S. Federal income tax liability. The limitation on foreign taxes eligible for the U.S. foreign tax credit is calculated separately with respect to "passive" income and "general" income. The rules relating to foreign tax credits and the timing thereof are complex. U.S. holders should consult their own tax advisors regarding the availability of a foreign tax credit under their particular situation.

Sale or Other Disposition of ADSs

If a U.S. holder sells or otherwise disposes of its ADSs, gain or loss will be recognized for U.S. Federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and such holder's adjusted tax basis in the ADSs. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss generally will be capital gain or loss and will be long-term capital gain or loss if the holder had held the ADSs for more than one year at the time of the sale or other disposition. Long-term capital gains realized by individual U.S. holders generally are subject to a lower marginal U.S. Federal income tax rate (15% for taxable years beginning on or before December 31, 2012) than ordinary income. Under most circumstances, any gain that a holder recognizes on the sale or other disposition of ADSs will be U.S. source for purposes of the foreign tax credit limitation and any recognized losses will be allocated against U.S. source income.

If a U.S. holder receives foreign currency upon a sale or exchange of ADSs, gain or loss, if any, recognized on the subsequent sale, conversion or disposition of such foreign currency will be ordinary income or loss, and will generally be income or loss from sources within the United States for foreign tax credit limitation purposes. However, if such foreign currency is converted into U.S. dollars on the date received by the U.S. holder, the U.S. holder generally should not be required to recognize any gain or loss on such conversion.

A U.S. Holder who holds shares through an Israeli stockbroker or other Israeli intermediary may be subject to Israeli withholding tax on any capital gains recognized if the U.S. Holder does not obtain approval of an exemption from the Israeli Tax Authorities or claim any allowable refunds or reductions. U.S. Holders are advised that any Israeli tax paid under circumstances in which an exemption from (or a refund of or a reduction in) such tax was available will not give rise to a deduction or credit for foreign taxes paid for U.S. federal income tax purposes. If applicable, U.S. Holders are advised to consult their Israeli stockbroker or intermediary regarding the procedures for obtaining an exemption or reduction.

Medicare Tax on Unearned Income

For taxable years beginning after December 31, 2012, certain U.S. holders that are individuals, estates or trusts to pay an additional 3.8% tax on, among other things, dividends and capital gains from the sale or other dispositions of ADSs.

Passive Foreign Investment Companies

For U.S. Federal income tax purposes, we will be considered a passive foreign investment company (“PFIC”) for any taxable year in which either 75% or more of our gross income is passive income, or at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income includes dividends, interest, royalties, rents, annuities and the excess of gain over losses from the disposition of assets which produce passive income. If we were determined to be a PFIC for U.S. Federal income tax purposes, highly complex rules would apply to U.S. holders owning ADSs.

Based on our estimated gross income, the average value of our gross assets and the nature of our business, we do not believe that we will be classified as a PFIC in the current taxable year. Our status in any taxable year will depend on our assets and activities in each year and because this is a factual determination made annually at the end of each taxable year, there can be no assurance that we will not be considered a PFIC for any future taxable year. If we were treated as a PFIC in any year during which a U.S. holder owns ADSs, certain adverse tax consequences could apply, as described below. Given our current business plans, however, we do not expect that we will be classified as a PFIC in future years.

If we are treated as a PFIC for any taxable year,

- a U.S. holder would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ADSs ratably over its holding period for such ADSs,

- the amount allocated to each year during which we are considered a PFIC other than the year of the dividend payment or disposition would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year,

- the amount allocated to the year of the dividend payment or disposition would be taxable as ordinary income, and

- a U.S. holder would be required to make an annual return on IRS Form 8621 regarding distributions received and gain realized with respect to ADSs.

One method to avoid the aforementioned treatment is for a U.S. holder to make an election to treat us as a qualified electing fund. A U.S. holder may make a qualified electing fund election only if we furnish the U.S. holder with certain tax information and we do not presently intend to prepare or provide this information. Alternatively, another method to avoid the aforementioned treatment is for a U.S. holder to make a timely mark-to-market election in respect of its ADSs. If a U.S. holder elects to mark-to-market its ADSs, any excess of the fair market value of the ADSs at the close of each tax year over the adjusted basis in such ADSs will generally be included in income. If the fair market value of the ADSs had depreciated below the adjusted basis at the close of the tax year, the U.S. holder may generally deduct the excess of the adjusted basis of the ADSs over its fair market value at that time. However, such deductions generally would be limited to the net mark-to-market gains, if any, that were included in income by such holder with respect to ADSs in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ADSs with respect to which the mark-to-market election is made, is treated as ordinary income or loss.

You are urged to consult your own tax advisor regarding the possibility of us being classified as a PFIC and the potential tax consequences arising from the ownership and disposition (directly or indirectly) of an interest in a PFIC.

Backup Withholding and Information Reporting

Payments of dividends with respect to ADSs and the proceeds from the sale, retirement, or other disposition of ADSs made by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. holder as may be required under applicable U.S. Treasury regulations. We, or an agent, a broker, or any paying agent, as the case may be, may be required to withhold tax (backup withholding), currently at the rate of 28% (which rate is currently scheduled to increase on January 1, 2013), if a non-corporate U.S. holder that is not otherwise exempt fails to provide an accurate taxpayer identification number and comply with other IRS requirements concerning information reporting. Certain U.S. holders (including, among others, corporations and tax-exempt organizations) are not subject to backup withholding. Any amount of backup withholding withheld may be used as a credit against your U.S. Federal income tax liability provided that the required information is furnished to the IRS. U.S. holders should consult their tax advisors as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Documents on Display

We are subject to certain of the information reporting requirements of the Securities and Exchange Act of 1934, as amended. We, as a "foreign private issuer" are exempt from the rules and regulations under the Securities Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and "short-swing" profit recovery provisions contained in Section 16 of the Securities Exchange Act, with respect to their purchase and sale of our shares. In addition, we are not required to file reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Securities Exchange Act. NASDAQ rules generally require that companies send an annual report to shareholders prior to the annual general meeting. We have an exception under the NASDAQ rules and follow the generally accepted business practice for companies in Israel. Specifically, we file annual reports on Form 20-F, which contain financial statements audited by an independent accounting firm, electronically with the SEC and post a copy on our website. We will also furnish to the SEC quarterly reports on Form 6-K containing unaudited financial information after the end of each of the first three quarters.

You may read and copy any document we file with the SEC at its public reference facilities at, 100 F Street, N.E., Washington, D.C. 20549 and at the SEC's regional offices at 500 West Madison Street, Suite 1400, Chicago, IL 60661-2511. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. The SEC also maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of this web site is http://www.sec.gov. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities. In addition, our ADSs are quoted on the NASDAQ Global Select Market, so our reports and other information can be inspected at the offices of the National Association of Securities Dealers, Inc. at 1735 K Street, N.W., Washington, D.C. 20006.

Item 11. Quantitative and Qualitative Disclosures About Market Risk.

General

Market risks relating to our operations result primarily from weak economic conditions in the markets in which we sell our products and changes in interest rates and exchange rates. To manage the volatility related to the latter exposure, we may enter into various derivative transactions. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in currency exchange rates. It is our policy and practice to use derivative financial instruments only to manage exposures. We do not use financial instruments for trading purposes and are not a party to any leveraged derivative.

Foreign Currency Risk

We conduct our business primarily in U.S. dollars but also in the currencies of the United Kingdom, the European Union and Israel as well as other currencies. Thus, we are exposed to foreign exchange movements, primarily in GBP, EUR and NIS. We monitor foreign currency exposure and, from time to time, may use various instruments to preserve the value of sales transactions and commitments; however, this cannot assure our protection against risks of currency fluctuations. For more information regarding foreign currency related risks, please refer to "General Business Risks Relating to Our Business and Market," on page 3. We use currency forward contracts and option contracts in order to protect against the increase in value of forecasted non-dollar currency cash flows and to hedge future anticipated payments relating to leasehold improvements.

As of December 31, 2011, we had outstanding forward contracts and currency options in the total amount of approximately $199.9 million. These transactions were for up to a one year period.

The table below details the balance sheet exposure (i.e., the gap between assets and liabilities in a given currency) by currency and geography, as of December 31, 2011. All data in the tables have been converted into U.S. dollar equivalents.

In U.S. dollars in millions:

| | U.S. Dollars | British Pound | Euro | New Israeli Shekel | Swiss Frank | Canadian Dollar | Hong Kong Dollar | Japanese Yen | Australian Dollar | Brazilian Real | Other currencies | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Israel | - | 7.26 | 2.94 | (26.96)* | 0.49 | 1.28 | (1.84) | (1.55) | 2.27 | - | (0.94) | (17.05) |
| European Union | 20.36 | (1.56) | 10.21 | - | 0.28 | - | (0.46) | 0.29 | - | - | 0.27 | 29.39 |
| Switzerland | (0.70) | 0.35 | 0.30 | - | - | - | - | - | - | - | - | (0.05) |
| United States of America | - | - | 0.24 | - | - | 0.58 | - | 1.56 | 0.93 | (0.32) | 0.25 | 3.24 |
| Canada | 2.20 | - | - | - | - | - | - | - | - | - | - | 2.20 |
| Hong Kong | 0.15 | - | (0.43) | - | - | - | - | - | - | - | 0.11 | (0.17) |
| Japan | - | - | (0.33) | - | - | - | (0.01) | - | - | - | - | (0.34) |
| Singapore | - | - | (0.18) | - | - | - | (0.02) | - | - | - | - | (0.20) |
| China | 0.20 | - | - | - | - | - | - | - | - | - | - | 0.20 |
| Australia | 1.04 | - | - | - | - | - | - | - | - | - | 0.02 | 1.06 |
| | | | | | | | | | | | | |
| | 23.25 | 6.05 | 12.75 | (26.96) | 0.77 | 1.86 | (2.33) | 0.30 | 3.20 | (0.32) | (0.29) | 18.28 |

Net Exposure:

| | NIS/ USD | GBP/ USD | EUR/ USD | CAD/ USD | HKD/ USD | BRL/ USD | AUD/ USD | CNY/ USD | GBP/ EUR | HKD/ EUR | JPY/ EUR | SGD/ EUR | CHF/ EUR | GBP/ CHF | GBP/ JPY |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Exposure | (26.96)* | 23.50 | 5.94 | 4.05 | (1.69) | (0.32) | 4.23 | 0.20 | 10.05 | (0.89) | (0.33) | (0.18) | 0.30 | 0.63 | 0.29 |

* Treasury Bills in an amount of $125.1 million (dominated in New Israeli Shekel) are not included in the tables above due to hedging contracts.

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The table below presents the fair value of firmly committed transactions for lease obligations denominated in currencies other than the functional currency:

In U.S. dollars in millions:

| | New Israel Shekel | Other currencies | Total |
|---|---|---|---|
| less than 1 year | 6.22 | 0.24 | 6.46 |
| 1-3 years | 13.72 | 0.06 | 13.78 |
| 3-5 years | 14.00 | 0.04 | 14.04 |
| Over 5 years | 40.23 | - | 40.23 |
| Total | 74.17 | 0.34 | 74.51 |

The fair value of derivative instruments and the notional amount of the hedged instruments are set forth in the table below:

In U.S. dollars in millions:

| | New Israeli Shekels | |
|---|---|---|
| | Notional Amount | Fair Value |
| Option contracts to hedge payroll expenses | 73.4 | (2.92) |
| Option contracts to hedge future anticipated payments relating to leasehold improvements | 3 | (0.028) |
| Forward contracts to hedge Israeli Treasury Bills (*) | 123.5 | 9.59 |

* The average investment in one-year Israeli Treasury Bills dominated in NIS during 2011 was approximately $150 million against which we have entered into Forward contracts to protect against the increase in value of forecasted non-dollar currency cash flows.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment in marketable securities and deposits. Our marketable securities portfolio consists of investment-grade corporate debentures, U.S. Government agency debentures, U.S. treasuries and Israeli Treasury bills. As of December 31, 2011, 77% of our portfolio was in such securities.

We invest in dollar deposits with U.S. banks, European banks, Israeli banks and money market funds. As of December 31, 2011, 23% of our portfolio was in such deposits. Since these investments are for short periods, interest income is sensitive to changes in interest rates.

The decline in interest rates due to the global credit crisis has a direct effect on our interest income and our ability to maintain our portfolio's yield level in line with prior years. In a market environment of declining interest rates, we are likely to reinvest the redeemed proceeds from our called or matured marketable securities in lower yielding investments. Conversely, an increase in market interest rates could also have an adverse effect on the value of our investment portfolio, for example, by decreasing the fair values of the fixed income securities that comprise a substantial majority of our investment portfolio.

The average duration of the securities portfolio, as of December 31, 2011, is 1.8 years. The securities in our portfolio are rated generally at the least as A- according to Standard and Poor's rating or A3, according to Moody's rating. Securities representing 13% of the portfolio are rated as AAA; securities representing 32% of the portfolio are rated as AA; securities representing 54% of the portfolio are rated as A; and securities representing 1% of the portfolio are rated as BBB+ after being downgraded during 2011.

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The fair value of marketable securities, which are subject to risk of changes in interest rate, segregated by maturity dates:

| In U.S. dollars in millions: | Amortized Cost | | | | Estimated fair value | | | |
|---|---|---|---|---|---|---|---|---|
| | Up to 1 year | 1-3 years | 4-5 years | Total | Up to 1 year | 1-3 years | 4-5 years | Total |
| Corporate debentures | 16.41 | 97.05 | 87.84 | 201.30 | 16.42 | 97.85 | 88.56 | 202.83 |
| U.S. Government agency debentures | 2.51 | 1.20 | 7.00 | 10.71 | 2.51 | 1.20 | 7.04 | 10.75 |
| US treasuries | - | 18.30 | - | 18.30 | - | 19.48 | - | 19.48 |
| Israeli Treasury Bills(*) | 124.68 | - | - | 124.68 | 125.07 | - | - | 125.07 |
| | 143.60 | 116.55 | 94.84 | 354.99 | 144.00 | 118.53 | 95.60 | 358.13 |

* These securities bear Israel sovereign risk which is rated A+ stable by Standard and Poor's and A1 stable by Moody's.

Other risks and uncertainties that could affect actual results and outcomes are described in Item 3, "Key Information—Risk Factors."

Item 12. Description of Securities Other than Equity Securities.

American Depositary Shares and Receipts

Set forth below is a summary of certain provisions in relation to charges and other payments under the Deposit Agreement, as amended, among NICE, The Bank of New York Mellon as depositary (the "Depositary"), and the owners and holders from time to time of ADRs (or the Deposit Agreement). This summary is not complete and is qualified in its entirety by the Deposit Agreement, a form of which has been filed as Exhibit A to the registration statement on Form F-6 (Registration No. 333-13518) filed with the SEC on May 17, 2001.

Charges of Depositary

We will pay the fees, reasonable expenses and out-of-pocket charges of the Depositary and those of any registrar only in accordance with agreements in writing entered into between us and the Depositary from time to time. The following charges shall be incurred by any party depositing or withdrawing ordinary shares or by any party surrendering ADRs or to whom ADRs are issued (including, without limitation, issuance pursuant to a stock dividend or stock split declared by us or an exchange of stock regarding the ADRs or deposited ordinary shares or a distribution of ADRs pursuant to the terms of the Deposit Agreement):

(1) any applicable taxes and other governmental charges,

(2) any applicable transfer or registration fees,

(3) certain cable, telex and facsimile transmission charges as provided in the Deposit Agreement,

(4) any expenses incurred in the conversion of foreign currency,

(5) a fee of $5.00 or less per 100 ADSs (or a portion thereof) for the execution and delivery of ADRs and the surrender of ADRs, and

(6) a fee for the distribution of proceeds of rights that the Depositary sells pursuant to the Deposit Agreement.

The Depositary may own and deal in our securities and in our ADRs.

Liability of Holders for Taxes, Duties or Other Charges

Any tax or other governmental charge with respect to ADRs or any deposited ordinary shares represented by any ADR shall be payable by the holder of such ADR to the Depositary. The Depositary may refuse to effect transfer of such ADR or any withdrawal of deposited ordinary shares represented by such ADR until such payment is made, and may withhold any dividends or other distributions or may sell for the account of the holder any part or all of the deposited ordinary shares represented by such ADR and may apply such dividends or distributions or the proceeds of any such sale in payment of any such tax or other governmental charge and the holder of such ADR shall remain liable for any deficiency.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies.

None.

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

None.

Item 15. Controls and Procedures.

Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of NICE's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of NICE's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that NICE's disclosure controls and procedures were effective as of such date.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as such term is defined in Rule 15d-15(f) under the Securities Exchange Act. Our internal control over financial reporting system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective can only provide reasonable assurance with respect to financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed our internal control over financial reporting as of December 31, 2011. Our management based its assessment on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management has concluded that, as of December 31, 2011, our internal control over financial reporting is effective.

Attestation Report of the Independent Registered Public Accounting Firm

Our independent registered public accounting firm, Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global independently assessed the effectiveness of our internal control over financial reporting and has issued an attestation report, which is included under Item 18 on page F-3 of this annual report.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this annual report that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Item 16. [Reserved].

Item 16A. Audit Committee Financial Expert.

Our board of directors has determined that Dan Falk meets the definition of an audit committee financial expert, as defined in Item 407 of Regulation S-K, and is independent under the applicable regulations.

Item 16B. Code of Ethics.

We have adopted a Code of Ethics that applies to our principal executive and financial officers, and that also applies to all of our employees. The Code of Ethics is publicly available on our website at www.nice.com. Written copies are available upon request. If we make any substantive amendments to the Code of Ethics or grant any waiver from a provision of this code to our chief executive officer, principal financial officer or corporate controller, we will either disclose the nature of such amendment or waiver on our website or in our annual report on Form 20-F.

On February 14, 2012, our Board of Directors approved an amendment to our Code of Ethics, which included new provisions regarding sexual harassment in the workplace and a revised section on bribery and corruption, as well as other non-material revisions.

Item 16C. Principal Accountant Fees and Services.

Fees Paid to Independent Auditors

Fees billed or expected to be billed by Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global, and other members of Ernst & Young Global for professional services for each of the last two fiscal years were as follows:

| Services Rendered | 2010 Fees | 2011 Fees |
|---|---|---|
| Audit (1) | $ 717,000 | $ 689,000 |
| Audit-related (2) | $ 138,000 | $ 195,000 |
| Tax (3) | $ 832,000 | $ 576,000 |
| Total | $ 1,687,000 | $ 1,460,000 |

(1) Audit fees are for audit services for each of the years shown in this table, including fees associated with the annual audit for 2011 (including audit in accordance with section 404 of the Sarbanes-Oxley act) and certain procedures regarding our quarterly financial results submitted on Form 6-K, consultations concerning financial accounting and various accounting issues and performance of local statutory audits.

(2) Audit-related fees relate to assurance and associated services that traditionally are performed by the independent auditor, including: accounting consultation and consultation concerning financial accounting, reporting standards and government approvals and due diligence investigations.

(3) Tax fees are for professional services rendered by our auditors for tax compliance, tax advice on actual or contemplated transactions, tax consulting associated with international transfer prices and global mobility of employees.

Policies and Procedures

Our audit committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our external auditors, Ernst & Young. The policy, which is designed to ensure that such services do not impair the independence of our auditors, requires pre-approval from the audit committee on an annual basis for the various audit and non-audit services that may be performed by our auditors. If a type of service, that is to be provided by our auditors, has not received such general pre-approval, it will require specific pre-approval by our audit committee. Any proposed services exceeding pre-approved cost levels or budgeted amounts will also require specific pre-approval by our audit committee. The policy prohibits retention of the independent auditors to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act of 2002 or the rules of the SEC, and also considers whether proposed services are compatible with the independence of the public auditors.

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

Not applicable.

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

During 2011, we repurchased our ordinary shares as described in the table below.

| Period | (a) Total number of shares purchased | (b) Average price paid per share | (c) Total number of shares purchased as part of publicly announced plans or programs | (d) Maximum number (or approximately dollar value) of shares that may yet be purchased under the plans or programs |
|---|---|---|---|---|
| February 1 - February 28 | N/A | N/A | N/A | 100,000,000 |
| March 1 - March 31 | 62,500 | 34.62 | 62,500 | 97,836,115 |
| April 1 - April 30 | 156,421 | 37.31 | 156,421 | 92,000,014 |
| May 1 - May 31 | 220,115 | 36.34 | 220,115 | 84,000,046 |
| June 1 - June 30 | 435,896 | 34.31 | 435,896 | 69,045,889 |
| July 1 - July 31 | 137,123 | 36.80 | 137,123 | 64,000,060 |
| August 1 - August 31 | 618,421 | 29.94 | 618,421 | 45,485,381 |
| September 1 - September 30 | 1,177,340 | 30.18 | 1,177,340 | 9,958,019 |
| October 1 - October 31 | 33,245 | 28.81 | 33,245 | 9,000,068 |
| November 1 - November 30 | N/A | N/A | N/A | 109,000,068 |
| December 1 - December 31 | 156,500 | 33.60 | 156,500 | 103,741,722 |
| Total | 2,997,561 | 32.11 | 2,997,561 | |

On February 15, 2011, we announced that our board of directors authorized a program to repurchase up to $100 million of our issued and outstanding ordinary shares and ADRs. Repurchases may be made from time to time in the open market or in privately negotiated transactions and will be in accordance with applicable securities laws and regulations. The timing and amount of the repurchase transactions will be determined by management and may depend on a variety of factors, including market conditions, alternative investment opportunities and other considerations. The program does not obligate us to acquire any particular amount of ordinary shares and ADRs and the program may be modified or discontinued at any time without prior notice.

On November 3, 2011, we announced that our board of directors authorized a new program to repurchase up to $100 million of our issued and outstanding ordinary shares and ADRs. Repurchases may be made from time to time in the open market or in privately negotiated transactions and will be in accordance with applicable securities laws and regulations. The timing and amount of the repurchase transactions will be determined by management and may depend on a variety of factors, including market conditions, alternative investment opportunities and other considerations. The program does not obligate us to acquire any particular amount of ordinary shares and ADRs and the program may be modified or discontinued at any time without prior notice.

On February 14, 2012, our board of directors authorized the cancellation of our ordinary shares and ADRs repurchased during 2011 within the framework of the repurchase program.

Item 16F. Change in Registrant's Certifying Accountant.

None.

Item 16G. Corporate Governance.

We follow the Israeli Companies Law, the relevant provisions of which are summarized in this annual report, rather than comply with the NASDAQ requirements relating to: (i) the quorum for shareholder meetings (see Item 10, "Additional Information – Memorandum and Articles of Association – Meetings of Shareholders" in this annual report); (ii) shareholder approval with respect to issuance of securities under equity based compensation plans (see Item 10, "Additional Information – Memorandum and Articles of Association – Approval of Certain Transactions" in this annual report); and (iii) sending annual reports to shareholders (see Item 10, "Additional Information – Documents on Display" in this annual report).

Item 16H. Mine Safety Disclosure.

Not Applicable.

PART III

Item 17. Financial Statements.

Not Applicable.

Item 18. Financial Statements.

See pages F-1 through F-56 of this annual report attached hereto.

Item 19. Exhibits.

| Exhibit No. | Description |
|---|---|
| 1.1 | Amended and Restated Memorandum of Association, as approved on December 21, 2006 (English translation) (filed as Exhibit 1.1 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on June 13, 2007, and incorporated herein by reference). |
| 1.2 | Amended and Restated Articles of Association, as amended on September 19, 2011 (filed as Exhibit 4.2 to NICE-Systems Ltd.'s Registration Statement on Form S-8 (Registration No. 333-177510) filed with the SEC on October 26, 2011, and incorporated herein by reference). |
| 2.1 | Form of Share Certificate (filed as Exhibit 4.1 to Amendment No. 1 to NICE-Systems Ltd.'s Registration Statement on Form F-1 (Registration No. 333-99640) filed with the SEC on December 29, 1995, and incorporated herein by reference). |
| 2.2 | Form of Deposit Agreement including Form of ADR Certificate (filed as Exhibit 1 to NICE-Systems Ltd.'s Registration Statement on Form F-6 (Registration No. 333-157371) filed with the SEC on February 17, 2011, and incorporated herein by reference). |
| 4.1 | Manufacturing Outsourcing Agreement dated January 21, 2002 by and among NICE-Systems Ltd. and Flextronics Israel Ltd. (filed as Exhibit 4.5 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on June 26, 2003, and incorporated herein by reference). |
| 4.2 | Asset Purchase Agreement, dated as of November 22, 2009, among Orsus Solutions Limited and its wholly-owned subsidiaries and NICE-Systems Ltd. and certain of its wholly-owned subsidiaries (filed as Exhibit 4.5 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on March 31, 2010, and incorporated herein by reference). |
| 4.3 | Agreement and Plan of Merger, dated as of June 9, 2010, among NICE-Systems Ltd., certain subsidiaries of the NICE-Systems Ltd., e-Glue Software Technologies, Inc. and certain shareholder representatives of e-Glue (filed as Exhibit 4.4 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on March 31, 2011, and incorporated herein by reference). |
| 4.4 | Share Purchase Agreement, dated as of March 4, 2011, among NICE-Systems Ltd., IEX Corporation B.V. and CyberTech Beheer B.V. and Stichting Administratiekantoor Cybertech (filed as Exhibit 4.5 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on March 31, 2011, and incorporated herein by reference). |
| 4.5 | Share Purchase Agreement dated as of September 18, 2011, by and among NICE-Systems Ltd. and shareholders of Fizzback Group (Holdings) Ltd. |
| 4.6 | Agreement and Plan of Merger dated as of December 1, 2011, by and among NICE-Systems, Inc., Moneyball Acquisition Corporation, Merced Systems, Inc. and shareholders of Merced Systems, Inc. |
| 4.7 | NICE Systems Ltd. 2003 Stock Option Plan, as amended (filed as Exhibit 4.4 to NICE-System Ltd.'s Annual Report on Form 20-F (File No. 000-27466) filed with the SEC on April 6, 2009, and incorporated herein by reference). |
| 4.8 | NICE Systems Ltd. Amended and Restated 1999 Employee Stock Purchase Plan (filed as Exhibit 4 to NICE-System Ltd.'s Registration Statement on Form S-8 (Registration No. 333-111113) filed with the SEC on May 22, 2006, and incorporated herein by reference). |
| 4.9 | Actimize Ltd. 2003 Omnibus Stock Option and Restricted Stock Incentive Plan (filed as Exhibit 4.4 to NICE-System Ltd.'s Registration Statement on Form S-8 (Registration No. 333-145981) filed with the SEC on September 11, 2007, and incorporated herein by reference). |

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| | |
|---|---|
| 4.10 | NICE Systems Ltd. 2008 Share Incentive Plan, as amended (filed as Exhibit 4.4 to NICE-System Ltd.'s Registration Statement on Form S-8 (Registration No. 333-171165) filed with the SEC on December 15, 2010, and incorporated herein by reference). |
| 4.11 | Orsus Solutions Limited 2007 Incentive Option Plan, as amended (filed as Exhibit 4.10 to NICE-Systems Ltd.'s Annual Report on Form 20-F filed with the SEC on March 31, 2010, and incorporated herein by reference). |
| 4.12 | e-Glue Software Technologies, Inc. 2004 Stock Option Plan, as amended (filed as Exhibit 4.4 to NICE-Systems Ltd.'s Registration Statement on Form S-8 (Registration No. 333-168100) filed with the SEC on July 14, 2010, and incorporated herein by reference). |
| 4.13 | Fizzback Group (Holdings) Limited Employee Share Option Scheme (filed as Exhibit 4.4 to NICE-Systems Ltd.'s Registration Statement on Form S-8 (Registration No. 333-177510) filed with the SEC on October 26, 2011, and incorporated herein by reference). |
| 4.14 | Merced Systems, Inc. 2001 Stock Plan (filed as Exhibit 4.4 to NICE-Systems Ltd.'s Registration Statement on Form S-8 (Registration No. 333-179408) filed with the SEC on February 7, 2012, and incorporated herein by reference). |
| 4.15 | Merced Systems, Inc. 2011 Stock Plan (filed as Exhibit 4.5 to NICE-Systems Ltd.'s Registration Statement on Form S-8 (Registration No. 333-179408) filed with the SEC on February 7, 2012, and incorporated herein by reference). |
| 8.1 | List of significant subsidiaries. |
| 12.1 | Certification by the Chief Executive Officer of NICE-Systems Ltd., pursuant to Section 302 of the Sarbanes-Oxley Act 2002. |
| 12.2 | Certification by the Chief Financial Officer of NICE-Systems Ltd., pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 13.1 | Certification by the Chief Executive Officer of NICE-Systems Ltd., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 13.2 | Certification by the Chief Financial Officer of NICE-Systems Ltd., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 15.1 | Consent of Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global. |
| 101 | The following financial information from NICE-Systems Ltd.'s Annual Report on Form 20-F for the year ended December 31, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2011 and 2010; (ii) Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009; (iii) Statements of Changes in Shareholders' Equity and Comprehensive Income for the years ended December 31, 2011, 2010 and 2009; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009; and (v) Notes to Consolidated Financial Statements. Users of this data are advised, in accordance with Rule 406T of Regulation S-T promulgated by the SEC, that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections. |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2011

IN U.S. DOLLARS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

NICE SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of NICE Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 29, 2012 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
March 29, 2012

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

NICE SYSTEMS LTD.

We have audited NICE Systems Ltd.'s ("the Company") internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("the COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting included in the accompanying Management's Annual Report on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders' equity and comprehensive income and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 29, 2012 expressed an unqualified opinion thereon.

Tel-Aviv, Israel
March 29, 2012

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 204,437 | $ 109,526 |
| Short term investments | 144,003 | 242,593 |
| Trade receivables (net of allowance for doubtful accounts of $ 4,671 and $ 4,102 at December 31, 2011 and 2010, respectively) | 126,981 | 99,257 |
| Other receivables and prepaid expenses | 43,941 | 31,924 |
| Inventories | 13,404 | 10,861 |
| Deferred tax assets | 10,405 | 6,798 |
| Total current assets | 543,171 | 500,959 |
| LONG-TERM ASSETS: | | |
| Long term investments | 214,136 | 311,081 |
| Other long-term assets | 28,890 | 31,118 |
| Property and equipment, net | 28,299 | 22,014 |
| Other intangible assets, net | 158,153 | 141,632 |
| Goodwill | 609,187 | 527,614 |
| Total long-term assets | 1,038,665 | 1,033,459 |
| Total assets | $ 1,581,836 | $ 1,534,418 |

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

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NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $19,014 | $20,019 |
| Deferred revenues and advances from customers | 160,242 | 140,388 |
| Accrued expenses and other liabilities | 190,372 | 166,643 |
| Total current liabilities | 369,628 | 327,050 |
| LONG-TERM LIABILITIES: | | |
| Accrued severance pay | 23,728 | 24,776 |
| Deferred tax liabilities | 27,766 | 19,705 |
| Other long-term liabilities | 2,070 | 2,127 |
| Total long-term liabilities | 53,564 | 46,608 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Share capital- | | |
| Ordinary shares of NIS 1 par value: | | |
| Authorized: 125,000,000 shares at December 31, 2011 and 2010; | | |
| Issued: 64,804,730 and 63,384,481 shares at December 31, 2011 and 2010, respectively | | |
| Outstanding: 61,807,169 and 63,384,481 shares at December 31, 2011 and 2010, respectively | 16,273 | 15,875 |
| Additional paid-in capital | 988,076 | 939,064 |
| Treasury shares at cost – 2,997,561 and 0 ordinary shares at December 31, 2011 and 2010, respectively | (96,318) | - |
| Accumulated other comprehensive income (loss) | (1,895) | 10,576 |
| Retained earnings | 252,508 | 195,245 |
| Total shareholders' equity | 1,158,644 | 1,160,760 |
| Total liabilities and shareholders' equity | $1,581,836 | $1,534,418 |

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

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NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Revenues: | | | |
| Products | $355,760 | $325,429 | $281,783 |
| Services | 438,071 | 364,022 | 301,332 |
| Total revenues | 793,831 | 689,451 | 583,115 |
| Cost of revenues: | | | |
| Products | 116,256 | 107,190 | 88,030 |
| Services | 191,049 | 161,885 | 149,175 |
| Total cost of revenues | 307,305 | 269,075 | 237,205 |
| Gross profit | 486,526 | 420,376 | 345,910 |
| Operating expenses: | | | |
| Research and development, net | 109,127 | 97,083 | 77,382 |
| Selling and marketing | 199,044 | 178,407 | 141,526 |
| General and administrative | 95,650 | 76,345 | 72,791 |
| Amortization of acquired intangibles | 23,677 | 19,489 | 16,012 |
| Total operating expenses | 427,498 | 371,324 | 307,711 |
| Operating income | 59,028 | 49,052 | 38,199 |
| Financial income and other, net | 9,856 | 8,981 | 7,597 |
| Income before taxes on income | 68,884 | 58,033 | 45,796 |
| Taxes on income | 11,621 | 9,326 | 3,040 |
| Net income | $57,263 | $48,707 | $42,756 |
| Net earnings per share: | | | |
| Basic | $0.91 | $0.78 | $0.70 |
| Diluted | $0.89 | $0.76 | $0.68 |

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

U.S. dollars in thousands

| | Share capital | Additional paid-in capital | Treasury shares | Accumulated other comprehensive income (loss) | Retained earnings | Total comprehensive income | Total shareholders' equity |
|---|---|---|---|---|---|---|---|
| Balance as of January 1, 2011 | $ 15,875 | $ 939,064 | $ - | $ 10,576 | $ 195,245 | | $ 1,160,760 |
| Assumption of restricted share units and options upon acquisition | - | 1,230 | - | - | - | | 1,230 |
| Issuance of shares of ESPP | 5 | 557 | - | - | - | | 562 |
| Exercise of share options | 391 | 25,683 | - | - | - | | 26,074 |
| Stock-based compensation | - | 21,159 | - | - | - | | 21,159 |
| Excess tax benefit from share-based payment arrangements | - | 372 | - | - | - | | 372 |
| Restricted shares vesting in respect of Actimize acquisition | 2 | 11 | - | - | - | | 13 |
| Treasury shares purchased | - | - | (96,318) | - | - | | (96,318) |
| Comprehensive income: | | | | | | | |
| Foreign currency translation adjustments | - | - | - | (6,944) | - | $ (6,944) | (6,944) |
| Unrealized losses on marketable securities, net | - | - | - | (32) | - | (32) | (32) |
| Unrealized losses on derivative instruments, net | - | - | - | (5,495) | - | (5,495) | (5,495) |
| Net income | - | - | - | - | 57,263 | 57,263 | 57,263 |
| Total comprehensive income | | | | | | $ 44,792 | |
| Balance as of December 31, 2011 | $ 16,273 | $ 988,076 | $ (96,318) | $ (1,895) | $ 252,508 | | $ 1,158,644 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Balance as of January 1, 2010 | $15,492 | $892,139 | $- | $8,585 | $146,538 | | $1,062,754 |
| | | | - | | | | |
| Issuance of shares of ESPP | 4 | 432 | - | - | - | | 436 |
| Exercise of share options | 364 | 25,409 | - | - | - | | 25,773 |
| Stock-based compensation | - | 21,054 | - | - | - | | 21,054 |
| Excess tax shortfall from share-based payment arrangements | - | (18 ) | - | - | - | | (18 ) |
| Restricted shares vesting in respect of Actimize acquisition | 15 | 48 | - | - | - | | 63 |
| Comprehensive income: | | | | | | | |
| Foreign currency translation adjustments | - | - | - | 135 | - | $ 135 | 135 |
| Unrealized losses on marketable securities, net | - | - | - | (1,116 ) | - | (1,116 ) | (1,116 ) |
| Unrealized gains on derivative instruments, net | - | - | - | 2,972 | - | 2,972 | 2,972 |
| Net income | - | - | - | - | 48,707 | 48,707 | 48,707 |
| | | | | | | | |
| Total comprehensive income | | | | | | $ 50,698 | |
| Balance as of December 31, 2010 | $15,875 | $939,064 | - | $10,576 | $195,245 | | $1,160,760 |

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

U.S. dollars in thousands

| | Share capital | Additional paid-in capital | Accumulated other comprehensive income (loss) | Retained earnings | Total comprehensive income | Total shareholders' equity |
|---|---|---|---|---|---|---|
| Balance as of January 1, 2009 | $ 15,157 | $ 853,226 | $ (1,343 ) | $ 103,782 | | $ 970,822 |
| Issuance of shares of ESPP | 5 | 370 | - | - | | 375 |
| Exercise of share options | 303 | 19,267 | - | - | | 19,570 |
| Stock-based compensation | 0 | 18,237 | - | - | | 18,237 |
| Excess tax benefit from share-based payment arrangements | 0 | 969 | - | - | | 969 |
| Restricted shares vesting in respect of Actimize acquisition | 27 | 70 | - | - | | 97 |
| Comprehensive income: | - | - | - | - | | |
| Foreign currency translation adjustments | - | - | 7,415 | - | $ 7,415 | 7,415 |
| Unrealized gains on marketable securities, net | - | - | 2,206 | - | 2,206 | 2,206 |
| Unrealized gains on derivative instruments, net | - | - | 307 | - | 307 | 307 |
| Net income | - | - | - | 42,756 | 42,756 | 42,756 |
| | | | | | | |
| Total comprehensive income | | | | | $ 52,684 | |
| Balance as of December 31, 2009 | $ 15,492 | $ 892,139 | $ 8,585 | $ 146,538 | | $ 1,062,754 |

As of December 31, 2011, 2010 and 2009, accumulated other comprehensive income (loss) was comprised of foreign currency translation adjustments of $ (1,213), $ 5,731 and $ 5,596, unrealized gains on marketable securities, net of tax, of $ 2,490, $ 2,522 and $ 3,638 and unrealized gains (losses) on derivative instruments, net of tax, of $ (3,172), $ 2,323 and $ (649), respectively.

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

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NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $57,263 | $48,707 | $42,756 |
| Adjustments required to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 66,958 | 57,110 | 47,217 |
| Stock-based compensation | 21,159 | 21,054 | 18,237 |
| Excess tax shortfall (benefit) from share-based payment arrangements | (372) | 18 | (969) |
| Accrued severance pay, net | 533 | (1,015) | (1,534) |
| Amortization of premium and accrued interest on marketable securities | 3,238 | 328 | 1,656 |
| Gain on marketable securities, net | (791) | (1,197) | (823) |
| Deferred taxes, net | (8,775) | (4,862) | (6,984) |
| Changes in operating assets and liabilities: | | | |
| Trade receivables, net | (20,621) | 6,344 | 8,898 |
| Other receivables and prepaid expenses | 5,812 | (4,200) | (2,265) |
| Inventories | (2,048) | 3,546 | (531) |
| Trade payables | (3,743) | (7,136) | 1,536 |
| Accrued expenses and other liabilities | 35,634 | 25,913 | 12,039 |
| Other | 127 | 410 | 453 |
| Net cash provided by operating activities | 154,374 | 145,020 | 119,686 |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (17,307) | (11,704) | (8,851) |
| Proceeds from sale of property and equipment | 84 | 13 | 70 |
| Investment in marketable securities | (202,768) | (387,988) | (197,499) |
| Proceeds from maturity of marketable securities | 229,482 | 66,635 | 140,396 |
| Proceeds from sale and call of marketable securities | 147,480 | 69,933 | 57,394 |
| Investment in short-term bank deposits | - | - | (110,021) |
| Proceeds from short-term bank deposits | - | 40,029 | 134,473 |
| Payments for business acquisitions, net of cash acquired | (143,377) | (52,267) | (84,926) |
| Capitalization of software development costs | (1,150) | (1,311) | (1,315) |
| Purchase of intangible assets | (3,000) | - | (1,000) |
| Net cash provided by (used in) investing activities | 9,444 | (276,660) | (71,279) |

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

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NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Cash flows from financing activities: | | | |
| Proceeds from issuance of shares upon exercise of options and ESPP | 26,751 | 25,984 | 19,948 |
| Purchase of treasury shares | (95,886) | - | - |
| Excess tax benefit (shortfall) from share-based payment arrangements | 372 | (18) | 969 |
| Net cash provided by (used in) financing activities | (68,763) | 25,966 | 20,917 |
| Effect of exchange rate changes on cash | (144) | 389 | 1,111 |
| Increase (decrease) in cash and cash equivalents | 94,911 | (105,285) | 70,435 |
| Cash and cash equivalents at the beginning of the year | 109,526 | 214,811 | 144,376 |
| Cash and cash equivalents at the end of the year | $204,437 | $109,526 | $214,811 |
| Supplemental disclosure of cash flows activities: | | | |
| Cash paid during the year for: | | | |
| Income taxes | $17,560 | $9,988 | $5,554 |
| Interest | $78 | $28 | $36 |
| Non-cash activities: | | | |
| Accrued liability with respect to treasury shares | $432 | $- | $- |
| Assumption of restricted share units and options upon the acquisition of Fizzback | $1,230 | $- | $- |

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

a. General:

NICE Systems Ltd. ("NICE") and subsidiaries (collectively - "the Company") is a leading provider of software solutions that sells its solutions worldwide and enables organizations to take action to improve customer experience and business results, ensure compliance, prevent financial crime, and enhance safety and security. The Company operates an Enterprise business which is comprised of Customer Interactions Solutions and Financial Crime and Compliance solutions, and a Security business. Across the Company’s businesses, its solutions capture structured and unstructured data from different types of interactions, transactions and events, including interactions at various customer touch points, financial transactions and security-related sensors. Such data is captured from phone calls, the web, emails, chat, video, radio and many others. Through cross-channel analytics, insights on the interactions, transactions and events are delivered to the organization. The extraction of insights through advanced analytics on the captured data enables organizations to take action and make an impact in real time and offline by driving a personalized response to these insights before, during and after the interactions, transactions or events. This allows organizations to improve business performance, increase operational efficiency, prevent financial crime, ensure compliance, and enhance safety and security. The Company’s Customer Interactions Solutions are implemented by contact centers of all sizes, back office operations, retail branches and financial trading floors, to improve operational efficiency, ensure regulatory compliance, enhance customer experience and grow revenue. Enterprise customers of the Company’s Customer Interactions Solutions span a variety of industries, such as financial services, telecommunications, healthcare, outsourcers, retail, media, travel, service providers, utilities, and others. Enterprise customers of the Company’s Financial Crime and Compliance Solutions are primarily financial services organizations, government agencies and related organizations. The Company’s solutions drive to enable such customers to fight financial crime, prevent fraud and money laundering and ensure trading compliance. NICE Security Solutions are deployed worldwide in public transportation systems, critical facilities, city centers, banks, airports, public safety agencies, law enforcement and intelligence agencies and organizations and national and internal security agencies. The Company’s Security Solutions offer incident life-cycle management, including prevention, prediction, real-time and post-incident analysis for security and safety operations. The Company’s Security Solutions also offer solutions for the interception, collection, processing and analysis of communications data.

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

b. Acquisitions:

1. Acquisition of CyberTech:

On March 4, 2011, the Company completed the acquisition of all of the outstanding shares of CyberTech Investments BV ("CyberTech"), a global provider of compliance recording solutions and value-added applications. The Company acquired CyberTech for an aggregate consideration of $ 59,436 in cash.

The addition of CyberTech solutions to the NICE portfolio broadened the Company's offering for financial institutions, strengthened commitments to the small and medium size business sector, and added to the Company's public safety solutions. It also enhanced the Company's positioning in EMEA and provided a product set that meets the needs of emerging markets, by offering a solution that accommodates large scale implementations with entry-level requirements. The value of goodwill is attributed to synergies between the NICE portfolio and CyberTech’s products and services. $ 35,562 from the goodwill was assigned to the Customer Interactions Solutions' reporting unit and the remaining amount of $ 6,275 was assigned to the Security Solutions reporting unit.

The acquisition was accounted for by the acquisition method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of CyberTech. The results of the CyberTech operations have been included in the consolidated financial statements since March 4, 2011.

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

| | |
|---|---|
| Cash | $ 736 |
| Trade receivables | 4,266 |
| Other receivables and prepaid expenses | 1,200 |
| Current deferred tax assets | 203 |
| Inventories | 981 |
| Long-term deposits | 20 |
| Property and equipment | 1,433 |
| Other intangible assets | 22,710 |
| Goodwill | 41,837 |
| | |
| Total assets acquired | 73,386 |
| | |
| Trade payables | (1,370) |
| Accrued expenses and other liabilities | (7,971) |
| Long-term deferred tax liabilities | (4,609) |
| | |
| Total liabilities assumed | (13,950) |
| | |
| Net assets acquired | $ 59,436 |

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

NOTE 1:- GENERAL (Cont.)

In performing the purchase price allocation, management considered, among other factors, analyses of historical financial performance, highest and best use of the acquired assets and estimates of future performance of CyberTech's business. The fair value of intangible assets was based on market participant approach using an income approach.

Intangible assets that are subject to amortization are amortized over their estimated useful lives using the straight-line method at an annual weighted average rate of 38%. The following table sets forth the components of intangible assets associated with the acquisition and their annual rates of amortization:

| | | Fair value | % |
|---|---|---|---|
| Core technology | $ | 10,900 | 20 |
| Customer relationships | | 8,200 | 33 |
| Covenant not to compete | | 1,210 | 100 |
| Backlog | | 2,400 | 100 |
| | | | |
| Total intangible assets | $ | 22,710 | |

2. Acquisition of Fizzback:

On October 26, 2011, the Company completed the acquisition of all of the outstanding shares of Fizzback Group (Holdings) Ltd. ("Fizzback"), a global provider of Voice of the Customer (VoC) solutions, providing software solutions for real-time customer feedback that drive customer loyalty and employee performance. Fizzback's solution helps companies listen, respond and act in real-time to their customers' comments. The Company acquired Fizzback for an aggregate consideration of $ 80,905. The total purchase price of Fizzback was composed of the following:

| | |
|---|---|
| Cash | $79,675 |
| Options and Restricted Share Units*) | 1,230 |
| | |
| Total purchase price | $80,905 |

*) Represents the fair value of the vested portion of 165,695 options and restricted shares of NICE granted upon consummation of the acquisition to the holders of partially vested options of Fizzback originally granted under the Fizzback Group (Holdings) Ltd. Employee Share Option Scheme. The fair value of these options was determined using a Black-Scholes-Merton valuation model with the following assumptions: expected life of 1-38 months, risk-free interest rate of 0.02%-0.48%, expected volatility of 36.98%-56.44% and no dividend yield.

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

NOTE 1:- GENERAL (Cont.)

The combination of Fizzback and NICE both improved Customer Experience Management (CEM) as well as operationalized VoC both for the contact center and across the enterprise. By adding direct customer feedback with the Fizzback solution, NICE now provides a complete CEM solution that delivers a holistic understanding of the customer by combining on one platform the VoC from each of the three feedback dimensions: direct, indirect and inferred. The value of goodwill is attributed to synergies between NICE portfolio and Fizzback's products and services and the strength of the Company's position in the market. The entire goodwill was assigned to the Customer Interactions Solutions reporting unit.

The acquisition was accounted for by the acquisition method and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired and liabilities assumed of Fizzback. The results of the Fizzback operations have been included in the consolidated financial statements since October 26, 2011.

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

| | |
|---|---|
| Cash | $687 |
| Trade receivables | 3,341 |
| Other receivables and prepaid expenses | 1,134 |
| Current deferred tax assets | 1,887 |
| Long-term deposits | 148 |
| Property and equipment | 984 |
| Other intangible assets | 46,075 |
| Goodwill | 44,157 |
| | |
| Total assets acquired | 98,413 |
| | |
| Trade payables | (1,426) |
| Accrued expenses and other liabilities | (5,024) |
| Long-term deferred tax liabilities | (11,058) |
| | |
| Total liabilities assumed | (17,508) |
| | |
| Net assets acquired | $80,905 |

In performing the purchase price allocation, management considered, among other factors, analyses of historical financial performance, highest and best use of the acquired assets and estimates of future performance of Fizzback's business. The fair value of intangible assets was based on market participant approach using an income approach.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

Intangible assets that are subject to amortization are amortized over their estimated useful lives using the straight-line method at an annual weighted average rate of 21%. The following table sets forth the components of intangible assets associated with the acquisition and their annual rates of amortization:

| | | Fair value | % |
|---|---|---|---|
| Core technology | $ | 29,834 | 17 |
| Customer relationships | | 8,879 | 20 |
| Covenant not to compete | | 1,898 | 50 |
| Brand name | | 5,464 | 33 |
| | | | |
| Total intangible assets | $ | 46,075 | |

3. Acquisitions in previous years:

In 2010, the Company completed the acquisitions of Orsus Solutions Ltd., Lamda Communication Networks Ltd, and e-Glue Software Technologies Inc. and its subsidiaries. Total fair value of purchase consideration for the acquisitions was $ 59,766, which includes cash paid for Common stock and estimated fair value of earn-out payments. In connection with these acquisitions, the Company recorded intangibles and goodwill in the amounts of $ 30,423 and $ 32,401, respectively. In 2011, the Company paid an additional amount of $ 5,689 primarily with respect to earn out for the acquisition of e-Glue.

In 2009, the Company completed the acquisitions of Syfact, Fortent Inc and Hexagon System Engineering Ltd. Total cash paid in consideration for the acquisitions was $ 85,336. In connection with these acquisitions, the Company recorded intangibles, In Process Research and Development (IPR&D) and goodwill in the amounts of $ 41,454, $ 1,440 and $ 45,349, respectively.

4. Unaudited pro forma condensed results of operations:

The following represents the unaudited pro forma condensed results of operations for the years ended December 31, 2011 and 2010, assuming that the acquisitions of CyberTech and Fizzback occurred on January 1, 2010. The pro forma information is not necessarily indicative of the results of operations that would have actually occurred had the acquisitions been consummated on those dates, nor does it purport to represent the results of operations for future periods.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

| | Year ended December 31, 2011 Unaudited | | Year ended December 31, 2010 Unaudited | |
|---|---|---|---|---|
| Revenues | $ | 812,048 | $ | 722,926 |
| Net income | $ | 47,477 | $ | 20,218 |
| Basic net earnings per share | $ | 0.75 | $ | 0.32 |
| Diluted net earnings per share | $ | 0.74 | $ | 0.31 |

5. Acquisition related costs for the years ended December 31, 2011 and 2010 amounted to $ 2,925 and $ 851, respectively, and were included mainly in general and administrative expenses.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

b. Financial statements in United States dollars:

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

NICE and certain subsidiaries' transactions and balances denominated in dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured to dollars in accordance with ASC 830, "Foreign Currency Matters". All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statements of income as financial income or expenses, as appropriate.

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

c. Principles of consolidation:

Intercompany transactions and balances have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term unrestricted highly liquid investments that are readily convertible into cash, with original maturities of three months or less at acquisition.

e. Marketable securities:

The Company accounts for investments in debt securities in accordance with ASC 320, "Investments - Debt and Equity Securities". Management determines the appropriate classification of its investments in debt securities at the time of purchase and re-evaluates such determinations at each balance sheet date.

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

The Company's securities are reviewed for impairment in accordance with ASC 320-10-65. If such assets are considered to be impaired, the impairment charge is recognized in earnings when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period and the Company's intent to sell, including whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For securities with an unrealized loss that the Company intends to sell, or it is more likely than not that the Company will be required to sell before recovery of their amortized cost basis, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet these criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while declines in fair value related to other factors are recognized in other comprehensive income (loss).

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Inventories:

Inventories are stated at the lower of cost or market value. The cost of raw materials is determined by the "standard cost" method, and the cost of finished goods on the basis of costs charged by third party manufacturer. The cost of work-in-progress related to long-term contracts includes materials, subcontractors and other direct costs.

Inventory write-downs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and discontinued products and for market prices lower than cost, if any. At the point of the loss recognition, a new lower cost basis for that inventory is established. In addition, the Company records a liability for firm non-cancelable and unconditional purchase commitments with contract manufacturers for quantities in excess of the Company's future demands forecast consistent with its valuation of excess and obsolete inventory. Inventory write-downs for 2011, 2010 and 2009 were $ 1,395, $ 1,203 and $ 1,586, respectively, and have been included in cost of revenues.

g. Property and equipment, net:

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

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

| | % |
|---|---|
| Computers and peripheral equipment | 33 |
| Office furniture and equipment | 6 - 20 |
| Vehicles | 15 |

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

h. Other intangible assets, net:

Intangible assets are amortized over their estimated useful lives using the straight-line method, at the following weighted average annual rates:

| | % |
|---|---|
| Core technology | 18 |
| Customer relationships and distribution network | 17 |
| Capitalized software development costs (see l below) | 33 |
| Trademarks | 27 |

| | |
|---|---|
| Covenant not to compete | 68 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Acquired IPR&D is capitalized and assessed for impairment at least annually until the completion of development and afterwards is amortized over its useful life. Impairment on acquired IPR&D of $ 1,425, $ 0 and $ 0 was recorded for the years 2011, 2010 and 2009, respectively.

i. Impairment of long-lived assets:

The Company's long-lived assets and identifiable intangibles that are subject to amortization are reviewed for impairment in accordance with ASC 360, "Property, Plant, and Equipment", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. In 2011, 2010 and 2009, no impairment indicators have been identified.

j. Goodwill:

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net tangible and intangible assets acquired. Under ASC 350, goodwill is not amortized, but rather is subject to an annual impairment test.

ASC 350 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired. Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value. The Company operates in three operation-based segments: Customer Interactions Solutions, Security Solutions and Financial Crime and Compliance Solutions, and these segments comprise its reporting units.

Fair value is determined using discounted cash flows. Significant estimates used in the fair value methodologies include estimates of future cash flows, future growth rates and the weighted average cost of capital of the reporting units. The Company performed annual impairment tests during the fourth quarter of 2011, 2010 and 2009 and did not identify any impairment losses.

k. Revenue recognition:

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

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from sales of product and software licensing are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectability is probable.

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

For multiple element arrangements within the scope of software revenue recognition guidance, revenues are allocated to the different elements in the arrangement under the "residual method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the residual method, at the outset of the arrangement with the customer, the Company defers revenue for the fair value of its undelivered elements (maintenance and professional services) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (products and software licenses) when the basic criteria in ASC 985-605 have been met. Any discount in the arrangement is allocated to the delivered element.

Starting January 1, 2011 the Company adopted the guidance of ASU 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB ASC Topic 605, Revenue Recognition) ("ASU 2009-13") and ASU 2009-14, Certain Arrangements That Include Software Elements, (amendments to FASB ASC Topic 985, Software) ("ASU 2009-14"). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendment eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance in determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. As such, the Company prospectively applied these provisions to all revenue arrangements entered into or materially modified after January 1, 2011. This guidance does not generally change the units of accounting for the Company’s revenue transactions. Most products and services qualify as separate units of accounting and the revenue is recognized when the applicable revenue recognition criteria are met. The Company’s arrangements generally do not include any provisions for cancellation, termination, or refunds that would significantly impact recognized revenue. While certain of the Company’s bundled products are now accounted for following ASC 605, the impact of the adoption of these standards was immaterial.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's revenue recognition policies provide that, when a sales arrangement contains multiple elements, such as software and non-software components that function together to deliver the products’ essential functionality, the Company allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its VSOE, if available, third party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available. The Company establishes VSOE of selling price using the price charged for a deliverable when sold separately and, in rare instances, using the price established by management having the relevant authority. When VSOE cannot be established, the Company attempts to establish selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company’s go-to-market strategy typically differs from that of its peers and its offerings contain a significant level of customization and differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor products’ selling prices are on a standalone basis. Therefore, the Company is typically not able to determine TPE. The best estimate of selling price is established considering several external and internal factors including, but not limited to, historical sales, pricing practices and geographies in which the Company offers its products. The determination of ESP is judgmental.

In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue, as amended.

For all periods presented, amounts billed to customers related to shipping and handling are classified as revenue, and the Company’s shipping and handling costs are included in cost of sales.

The Company's policy for establishing VSOE of fair value of maintenance services is based on the price charged when the maintenance is renewed separately. Establishment of VSOE of fair value of professional services is based on the price charged when these services are sold separately.

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from fixed price contracts that require significant customization, integration and installation are recognized based on ASC 605-35, "Construction-Type and Production-Type Contracts", using the percentage-of-completion method of accounting based on the ratio of costs related to contract performance incurred to date to the total estimated amount of such costs. The amount of revenue recognized is based on the total fees under the arrangement and the percentage of completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contact.

The Company maintains a provision for product returns in accordance with ASC 605, "Revenue Recognition". The provision is estimated based on the Company's past experience and is deducted from revenues. As of December 31, 2011 and 2010, the provision for product returns amounted to $ 2,237 and $ 2,810, respectively.

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

l. Research and development costs:

Research and development costs (net of grants) incurred in the process of software production before establishment of technological feasibility are charged to expenses as incurred. Costs incurred to develop software to be sold are capitalized after technological feasibility is established in accordance with ASC 985-20, "Software - Costs of Software to be Sold, Leased, or Marketed". Based on the Company's product development process, technological feasibility is established upon completion of a detailed program design.

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

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

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes". This topic prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized.

The Company implements a two-step approach to recognize and measure uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% (cumulative basis) likely to be realized upon ultimate settlement.

The Company classifies interest as financial expenses and penalties as general and administrative expenses.

n. Government grants:

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

o. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables, marketable securities and foreign currency derivative contracts.

The Company's cash and cash equivalents are invested in deposits mainly in dollars with major international banks. Deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Generally, these deposits may be redeemed upon demand and therefore bear minimal risk.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's trade receivables are derived from sales to customers located primarily in North America, EMEA and APAC. The Company performs ongoing credit evaluations of its customers and obtains letters of credit and bank guarantees for certain receivables. Additionally, the Company insures certain of its receivables with a credit insurance company. A general allowance for doubtful accounts is provided, based on the length of time the receivables are past due.

The Company's marketable securities include investment in corporate debentures, U.S. Treasuries, U.S. government agency debentures and Israeli Treasury Bills. The Company's investment policy limits the amount that the Company may invest in any one type of investment or issuer, thereby reducing credit risk concentrations.

The Company entered into forward contracts, and option contracts intended to protect against the increase in value of forecasted non-dollar currency cash flows resulting from investments in Israeli Treasury Bills and payroll expenses and entered into option contracts to hedge future anticipated payments relating to a leasehold improvement. The derivative instruments hedge a portion of the Company's non-dollar currency exposure. See Notes 2v and 11 below.

p. Severance pay:

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

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

The Company's agreements with employees in Israel, joining the Company since May 1, 2009, are in accordance with Section 14 of the Severance Pay Law, 1963, whereas, the Company's contributions for severance pay shall be instead of its severance liability. Upon contribution of the full amount of the employee's monthly salary, and release of the policy to the employee, no additional calculations shall be conducted between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee. Further, the related obligation and amounts deposited on behalf of such obligation are not stated on the balance sheet, as they are legally released from obligation to employees once the deposit amounts have been paid.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Severance pay expense for 2011, 2010 and 2009 amounted to \$ 12,090, \$ 8,978 and \$ 7,709, respectively.

The Company has a 401(K) defined contribution plan covering certain employees in the U.S. All eligible employees may elect to contribute up to 6% of their eligible compensation, but generally not greater than \$ 16.5 per year, (for certain employees over 50 years of age the maximum contribution is \$ 22 per year) of their annual compensation to the plan through salary deferrals, subject to IRS limits. The Company matches 50% of employee contributions to the plan up to a limit of 6% of their eligible compensation. In the years 2011, 2010 and 2009, the Company recorded an expense for matching contributions in the amount of \$ 3,129, \$ 2,723 and \$ 2,330, respectively.

q. Basic and diluted net earnings per share:

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year plus dilutive potential equivalent ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings per Share".

The weighted average number of shares related to outstanding anti-dilutive options and restricted shares excluded from the calculations of diluted net earnings per share was 1,096,069, 2,086,379 and 3,867,517 for the years 2011, 2010 and 2009, respectively.

r. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation - Stock Compensation", which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated income statements.

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

s. Fair value of financial instruments:

The Company applies ASC 820, "Fair Value Measurements and Disclosures". Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. ASC 820 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The hierarchy is broken down into three levels based on the inputs as follows:

- Level 1 - Valuations based on quoted prices in active markets for identical assets that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

- Level 2 - Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The availability of observable inputs can vary from investment to investment and is affected by a wide variety of factors, including, for example, the type of investment, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment and the investments are categorized as Level 3.

The Company's marketable securities trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency and accordingly are categorized as Level 2.

Foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The following tables present assets and liabilities measured at fair value on a recurring basis at December 31, 2011 and 2010:

| | 2011 | | | |
|---|---|---|---|---|
| | Fair value measurements using input type | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Marketable securities: | | | | |
| Corporate debentures | $ - | $ 202,834 | $ - | $ 202,834 |
| U.S. Treasuries | - | 19,482 | - | 19,482 |
| U.S. Government agency debentures | - | 10,748 | - | 10,748 |
| Israeli Treasury Bills | - | 125,067 | - | 125,067 |
| Total marketable securities | $ - | $ 358,131 | $ - | $ 358,131 |
| Derivative assets | $ - | $ 9,587 | $ - | $ 9,587 |
| Derivative liabilities | $ - | $ (2,948 ) | $ - | $ (2,948 ) |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

| | 2010 | | | |
|---|---|---|---|---|
| | Fair value measurements using input type | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Marketable securities: | | | | |
| Corporate debentures | $ - | $ 349,327 | $ - | $ 349,327 |
| U.S. Treasuries | - | 18,948 | - | 18,948 |
| U.S. Government agency debentures | - | 32,985 | - | 32,985 |
| Israeli Treasury Bills | - | 152,412 | - | 152,412 |
| Total marketable securities | $ - | $ 553,672 | $ - | $ 553,672 |
| Derivative assets | $ - | $ 2,423 | $ - | $ 2,423 |
| Derivative liabilities | $ - | $ (8,775) | $ - | $ (8,775) |

The carrying amounts of financial instruments carried at cost, including cash and cash equivalents, short-term bank deposits, trade receivables and trade payables approximate their fair value due to the short-term maturities of such instruments.

t. Legal contingencies:

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

u. Advertising expenses:

Advertising expenses are charged to expense as incurred. Advertising expenses for the years 2011, 2010 and 2009 were $ 7,887, $ 6,969 and $ 5,883, respectively.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

v. Derivatives and hedging activities:

The Company carries out transactions involving foreign currency exchange derivative financial instruments. The transactions are designed to hedge the Company's exposure in currencies other than the dollar. The Company recognizes derivative instruments as either assets or liabilities and measures those instruments at fair value. If a derivative meets the definition of a cash flow hedge and is so designated, changes in the fair value of the derivative are recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative qualified and designated as a hedge is recognized in earnings. If a derivative does not meet the definition of a hedge, the changes in the fair value are included in earnings.

w. Treasury shares:

The Company repurchases its ordinary shares from time to time on the open market or in other transactions and holds such shares as treasury shares. The Company presents the cost to repurchase treasury stock as a reduction of shareholders’ equity.

x. Recently issued accounting standards:

In September 2011, the Financial Accounting Standards Board, or FASB issued ASU 2011-08, Testing Goodwill for Impairment, codified in ASC 350 "Intangibles – Goodwill and Other". The revised accounting standard update intended to simplify how an entity tests goodwill for impairment. The amendment will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This accounting standard update will be effective for the Company beginning January 1, 2012. The Company does not expect the adoption of this new guidance to have a material impact on its financial statements.

In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income, codified in ASC 220 "Comprehensive Income". The guidance requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance also eliminates the option to present the components of other comprehensive income as part of the statement of equity. In December 2011, the FASB issued ASU 2011-12, deferring the effective date for amendments outlined in ASU 2011-05. The Company is still evaluating whether to present other comprehensive income in a single continuous statement of comprehensive income or in two separate but consecutive statements.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In May 2011, the FASB issued ASU 2011-04 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, codified in ASC 820 "Fair Value Measurement". The guidance requires an entity to provide a consistent definition of fair value to ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements, and will become effective for the Company beginning January 1, 2012. The Company does not expect the adoption of this new guidance to have a material impact on its financial statements.

NOTE 3:- SHORT TERM AND LONG TERM INVESTMENTS

Short-term and long-term investments include marketable securities in the amount of $ 358,131 and $ 553,672 as of December 31, 2011 and 2010, respectively and short term bank deposits in the amounts of $ 8 and $ 2 as of December 31, 2011 and 2010, respectively.

The following table summarizes amortized costs, gross unrealized gains and losses and estimated fair values of available-for-sale marketable securities as of December 31, 2011 and 2010:

| | Amortized cost December 31, | | Gross unrealized gains December 31, | | Gross unrealized losses December 31, | | Estimated fair value December 31, | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Corporate debentures | $ 201,301 | $ 347,114 | $ 3,089 | $ 3,402 | $ 1,556 | $ 1,189 | $ 202,834 | $ 349,327 |
| U.S. Treasuries | 18,302 | 18,075 | 1,180 | 873 | - | - | 19,482 | 18,948 |
| U.S. Government agency debentures | 10,709 | 32,996 | 40 | 40 | 1 | 51 | 10,748 | 32,985 |
| Israeli Treasury Bills | 124,679 | 152,451 | 388 | 5 | - | 44 | 125,067 | 152,412 |
| | $ 354,991 | $ 550,636 | $ 4,697 | $ 4,320 | $ 1,557 | $ 1,284 | $ 358,131 | $ 553,672 |

The scheduled maturities of available-for-sale marketable securities as of December 31, 2011 were as follows:

| | Amortized cost | Estimated fair value |
|---|---|---|
| Due within one year | $ 143,600 | $ 143,995 |

| | | | | |
|---|---|---|---|---|
| Due after one year through five years | | 211,391 | | 214,136 |
| | | | | |
| | $ | 354,991 | $ | 358,131 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4:- OTHER RECEIVABLES AND PREPAID EXPENSES

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Government authorities | $ 17,495 | $ 9,446 |
| Interest receivable | 11,513 | 5,114 |
| Prepaid expenses | 9,929 | 10,962 |
| Other | 5,004 | 6,402 |
| | $ 43,941 | $ 31,924 |

NOTE 5:- INVENTORIES

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Raw materials | $ 2,120 | $ 2,509 |
| Work-in-progress | 2,768 | 1,324 |
| Finished goods | 8,516 | 7,028 |
| | $ 13,404 | $ 10,861 |

NOTE 6:- OTHER LONG-TERM ASSETS

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Investment in affiliate | $ 236 | $ 236 |
| Severance pay fund | 21,405 | 22,986 |
| Long-term deposits | 2,183 | 2,227 |
| Deferred tax assets | 5,066 | 5,669 |
| | $ 28,890 | $ 31,118 |

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

NOTE 7:- PROPERTY AND EQUIPMENT, NET

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Cost: | | |
| Computers and peripheral equipment | $ 87,119 | $ 73,714 |
| Office furniture and equipment | 15,583 | 14,596 |
| Leasehold improvements | 13,848 | 11,950 |
| Vehicles | 158 | - |
| | 116,708 | 100,260 |
| Accumulated depreciation: | | |
| Computers and peripheral equipment | 68,062 | 60,046 |
| Office furniture and equipment | 12,200 | 11,397 |
| Leasehold improvements | 8,091 | 6,803 |
| Vehicles | 56 | - |
| | 88,409 | 78,246 |
| Depreciated cost | $ 28,299 | $ 22,014 |

Depreciation expense totaled $ 12,959, $ 11,757 and $ 11,570 for the years 2011, 2010 and 2009, respectively.

NOTE 8:- OTHER INTANGIBLE ASSETS, NET

a. Definite-lived other intangible assets:

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Original amounts: | | |
| Core technology | $ 189,446 | $ 147,083 |
| Customer relationships and distribution network | 150,162 | 133,080 |
| Capitalized software development costs | 11,217 | 10,691 |
| Trademarks | 15,469 | 8,927 |
| Covenant not to compete | 3,076 | 100 |
| | 369,370 | 299,881 |
| Accumulated amortization: | | |
| Core technology | 110,194 | 84,697 |
| Customer relationships and distribution network | 81,709 | 59,238 |
| Capitalized software development costs | 8,622 | 7,903 |
| Trademarks | 9,535 | 7,766 |
| Covenant not to compete | 1,157 | 15 |

| | | |
|---|---|---|
| | 211,217 | 159,619 |
| Other intangible assets, net | $ 158,153 | $ 140,262 |

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

NOTE 8:- OTHER INTANGIBLE ASSETS, NET (Cont.)

b. Amortization expense amounted to $ 52,574, $ 45,353 and $ 35,647 for the years 2011, 2010 and 2009, respectively.

c. Estimated amortization expense (excluding amortization of capitalized software development costs):

For the year ended December 31,

| | | |
|---|---|---|
| 2012 | $ | 52,881 |
| 2013 | | 43,313 |
| 2014 | | 26,947 |
| 2015 | | 18,275 |
| 2016 | | 10,147 |
| 2017 and thereafter | | 3,995 |
| | | |
| | $ | 155,558 |

d. Indefinite-lived intangible assets consist of IPR&D in the amounts of $ 0 and $ 1,370 as of December 31, 2011 and 2010, respectively.

NOTE 9:- GOODWILL

The changes in the carrying amount of goodwill allocated to reportable segments for the years ended December 31, 2011 and 2010 are as follows:

| | Year ended December 31, 2011 | | | |
|---|---|---|---|---|
| | Customer Interactions Solutions | Security Solutions | Financial Crime and Compliance Solutions | Total |
| As of January 1, 2011 | $ 214,805 | $ 52,129 | $ 260,680 | $ 527,614 |
| | | | | |
| Acquisitions | 79,719 | 6,275 | - | 85,994 |
| Functional currency translation adjustments | (3,934 ) | (426 ) | (61 ) | (4,421 ) |
| | | | | |
| As of December 31, 2011 | $ 290,590 | $ 57,978 | $ 260,619 | $ 609,187 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- GOODWILL (Cont.)

| | Year ended December 31, 2010 | | | |
|---|---|---|---|---|
| | Customer Interactions Solutions | Security Solutions | Financial Crime and Compliance Solutions | Total |
| As of January 1, 2010 | $ 191,027 | $ 42,039 | $ 261,432 | $ 494,498 |
| Acquisitions | 22,576 | 9,825 | - | 32,401 |
| Functional currency translation adjustments | 1,202 | 265 | (752 ) | 715 |
| As of December 31, 2010 | $ 214,805 | $ 52,129 | $ 260,680 | $ 527,614 |

NOTE 10:- ACCRUED EXPENSES AND OTHER LIABILITIES

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Employees and payroll accruals | $ 59,713 | $ 43,925 |
| Accrued expenses | 71,040 | 74,455 |
| Government authorities | 57,683 | 47,317 |
| Other | 1,936 | 946 |
| | $ 190,372 | $ 166,643 |

NOTE 11:- DERIVATIVE INSTRUMENTS

The Company's risk management strategy includes the use of derivative financial instruments to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates.

ASC 815, "Derivatives and Hedging", requires the Company to recognize all of its derivative instruments as either assets or liabilities on the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- DERIVATIVE INSTRUMENTS (Cont.)

The Company entered into derivative instrument arrangements to hedge a portion of anticipated New Israeli Shekel ("NIS") payroll payments, to hedge forecasted Euro payments received from construction-type contract net of Euro payments to sub-contractors and to hedge future anticipated payments relating to leasehold improvements. These derivative instruments are designated as cash flow hedges, as defined by ASC 815. The transactions to hedge salary payments and net receivables from construction-type contract are made on denominated amounts that are no greater than forecasted cash flows for salaries and benefits and forecasted net receivables from construction-type contracts according to the Company's budget and on the dates that the cash flows are expected to be paid or received. These transactions are effective and as a result, are recorded as payroll expenses or as cost of revenues, respectively, at the time that the hedged income/expense is recorded. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the line item associated with the hedged transaction in the period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in financial income (expense) in the period of change.

The Company also entered into forward contracts, to hedge Israeli Treasury Bills denominated in NIS against changes in U.S. dollar/NIS exchange rate fluctuations. These derivative instruments are also designated as cash flow hedges and accordingly are measured in fair value. The Company records the effective portion of any gain or loss in other comprehensive income and then reclassifies amounts from other comprehensive income to financial income (expense) to offset the foreign exchange earnings impact of the hedged available-for-sale securities.

| | Notional amount December 31, | | Fair value December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Option contracts to hedge payroll expenses | $ 73,400 | $ 58,000 | $ (2,920 ) | $ 2,423 |
| Option contracts to hedge future anticipated payments relating to leasehold improvements | 3,000 | - | (28 ) | - |
| Forward contracts to hedge Israeli Treasury Bills | 123,501 | 150,872 | 9,587 | (8,775 ) |
| | $ 199,901 | $ 208,872 | $ 6,639 | $ (6,352 ) |

The Company currently hedges its exposure to the variability in future cash flows for a maximum period of one year. At December 31, 2011, the Company expects to reclassify all of the net loss on derivative instruments in the amount of $ 3,172 from accumulated other comprehensive income to earnings during the next twelve months.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- DERIVATIVE INSTRUMENTS (Cont.)

The fair value of the Company's outstanding derivative instruments at December 31, 2011 and 2010 is summarized below:

| | Balance sheet location | Fair value of derivative instruments December 31, 2011 | 2010 |
|---|---|---|---|
| Derivative assets: | | | |
| Foreign exchange option contracts | | $ - | $ 2,425 |
| Foreign exchange forward contracts | | 9,587 | - |
| | | $ 9,587 | $ 2,425 |
| Derivative liabilities: | | | |
| Foreign exchange option contracts | | $ (2,948) | $ (2) |
| Foreign exchange forward contracts | | - | (8,775) |
| | | $ (2,948) | $ (8,777) |
| Derivative assets | Other receivables and prepaid expenses | $ 9,587 | $ 2,423 |
| Derivative liabilities | Accrued expenses and other liabilities | $ (2,948) | $ (8,775) |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- DERIVATIVE INSTRUMENTS (Cont.)

The effect of derivative instruments in cash flow hedging relationship on income and other comprehensive income for the years ended December 31, 2011, 2010 and 2009 is summarized below:

| | Amount of gain (loss) recognized in OCI on derivative (effective portion) Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Derivatives in cash flow hedging relationship: | | | |
| Foreign exchange option contracts | $ 2,929 | $ (3,193) | $ (1,171) |
| Foreign exchange forward contracts | 10,537 | (893) | 2,888 |
| | | | |
| | $ 13,466 | (4,086) | $ 1,717 |

| | Statements of income line item | Amount of gain (loss) reclassified from OCI into income (expenses) (effective portion) Year ended December 31, | | |
|---|---|---|---|---|
| | | 2011 | 2010 | 2009 |
| Derivative in cash flow hedging relationship: | | | | |
| Foreign exchange option contracts | Cost of revenues and operating expenses | $ (1,930) | $ (1,127) | $ 670 |
| Foreign exchange forward contracts | Cost of revenues and operating expenses | - | 51 | (2,665) |
| Foreign exchange forward contracts | Financial income | 9,902 | (39) | - |
| | | | | |
| | | $ 7,972 | $ (1,115) | $ (1,995) |

The ineffective portion of the gain (loss) resulting from the change in fair value of a cash flow hedge for the years ended December 31, 2011, 2010 and 2009 amounted to $ 0, $ 38 and $ (30), respectively.

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NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

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

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

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

| | |
|---|---|
| 2012 | $ 15,800 |
| 2013 | 13,172 |
| 2014 | 12,059 |
| 2015 | 10,449 |
| 2016 | 10,201 |
| 2017 and thereafter | 50,264 |
| | |
| | $ 111,945 |

Rent expenses for the years 2011, 2010 and 2009 were approximately $ 18,607, $ 16,202 and $ 14,808, respectively.

2.The Company leases its motor vehicles under cancelable operating lease agreements.

The minimum payment under these operating leases, upon cancellation of these lease agreements was $ 1,297 as of December 31, 2011.

Lease expenses for motor vehicles for the years 2011, 2010 and 2009 were $ 5,707, $ 5,507 and $ 5,249, respectively.

b. Other commitments:

The Company is obligated under certain agreements with its suppliers to purchase goods and under an agreement with its manufacturing subcontractor to purchase projected inventory and excess inventory. Non cancelable obligations, net of provisions, as of December 31, 2011, were $ 2,073. These obligations will be fulfilled during 2012.

The Company is also obligated under certain agreements with its suppliers to purchase licenses and hosting services. Non cancelable obligations as of December 31, 2011, were $ 1,064.

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

c. Legal proceedings:

1. In December 2006, Calyon Corporate and Investment Bank ("Calyon") filed a suit against the Company in the District Court of Tel Aviv, demanding repayment of $ 648 plus accrued interest, for a total amount of $ 740. The Company deducted this amount in January 2004 from a payment transferred in connection with the acquisition of Thales Contact Solutions ("TCS"). The Company had notified TCS in 2004 that it had set off such amount with respect to an overdue payment by TCS to the Company. The dispute was submitted to mediation, however the mediation process failed and the proceedings were returned to the District Court of Tel Aviv. A trial was held on September 11, 2011, and the parties submitted their written summations and now await the Court’s decision. The Company is currently unable to evaluate the probability of a favorable or unfavorable outcome.

2. On September 16, 2009, Fair Isaac Corporation ("FICO") filed a claim in the United States District Court for the District of Delaware against Actimize Inc. and the Company, claiming that Actimize and the Company are infringing two U.S. patents. These patents cover various aspects of fraud detection. FICO requested damages and an injunction. On December 17, 2009, the parties agreed to dismiss the Company from the action. On December 21, 2009, Actimize filed a response and counterclaims. On January 25, 2010, Actimize filed an amended response and counterclaims. On January 25, 2011, FICO filed a first amended complaint, adding new allegations of infringement of two additional U.S. patents and allegations of willful infringement. The parties are currently engaged in fact discovery. A ten-day jury trial is scheduled for January 28, 2013. On January 18, 2012, the parties both agreed to the Court’s proposed terms of settlement, and a negotiated settlement agreement is due to be presented to the Court by the parties by April 23, 2012. See also 7 below.

3. On March 10, 2010, Nuvation Research Corporation ("Nuvation") filed a lawsuit against the Company with the Supreme Court of the State of New York. The lawsuit alleges, among others, that the Company breached a contract for design and development with Nuvation and defrauded Nuvation. Nuvation is claiming damages in a total amount of $ 8,000. On May 3, 2010, the Company filed an Answer and Counterclaim against Nuvation, denying the allegations and further claiming that the Company had the right to terminate its contract with Nuvation, and that as a consequence of the termination, the Company sustained damages in the amount of $ 5,000. On or about September 19, 2011, the parties reached an agreement in principle to settle the dispute through binding arbitration/mediation. The parties had a one-day arbitration/mediation on March 14, 2012 and are awaiting the arbitrator's decision. See also 7 below.

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

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

4. On July 15, 2010, Tal-Yam Engineering Projects Management and Initiation ("Tal-Yam") filed a suit against the Company in the Tel Aviv Magistrate's Court. The suit alleges a breach of contract due to failure to pay for services rendered to the Company. Tal-Yam is seeking damages in the amount of approximately NIS 1.0 million (approximately $ 262) and disclosure of certain invoices and related documentation. The Company submitted its statement of defense on October 24, 2010. The parties participated in mediation proceedings under Israeli Law that were not successful. Pre-trial proceedings are currently taking place. At this preliminary stage of the proceedings, the Company is unable to evaluate the probability of a favorable or unfavorable outcome.

5. Labor disputes:

On October 15, 2007, a former employee of Actimize Ltd., a wholly owned subsidiary of the Company, filed a claim with the Tel Aviv District Labor Court, seeking a declaration, that he is entitled to 0.5% of the outstanding share capital of Actimize Ltd. The preliminary stages of the claim ended and the parties submitted their testimonies by way of written affidavits. The hearing and cross-examination of the testimonies took place on June 16 and June 23, 2010. On July 31, 2011, the court ruled in favor of Actimize, dismissing all claims filed by the former employee and ordering him to pay expenses.

On August 20, 2010, a former employee of IEX Corp., a wholly owned subsidiary of the Company filed a complaint with the District Court of the Northern District of Illinois, alleging that the Company and IEX Corp. engaged in prohibited discrimination in terminating his employment. The case was settled during April 2011 and the matter is no longer pending.

6. The Company is involved in various other legal proceedings arising in the normal course of its business. Based upon the advice of counsel, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

7. The Company accrued a liability for all legal proceedings where the loss is considered probable and the amount can be reasonably estimated. The amount accrued at December 31, 2011 was immaterial.

NOTE 13:- TAXES ON INCOME

a. Israeli taxation:

1. Corporate tax rates in Israel:

Taxable income of Israeli companies is subject to tax at the rate of 26% in 2009, 25% in 2010, 24% in 2011 and 25% in 2012 and onwards.

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

Various industrial projects of NICE and its Israeli subsidiary have been granted "Approved Enterprise" and "Privileged Enterprise" status, which provides certain benefits, including tax exemptions and reduced tax rates. Income not eligible for Approved Enterprise and Privileged Enterprise benefits is taxed at a regular rate.

In the event of distribution of dividends from the said tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's income. The tax-exempt income attributable to the "Approved Enterprise" programs mentioned above can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of NICE or its Israeli subsidiary. Tax-exempt income generated under the Company's Privileged Enterprise program will be subject to taxes upon dividend distribution (which includes the repurchase of the Company's shares) or complete liquidation.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Law and regulations published thereunder. Should the Company fail to meet such requirements in the future, income attributable to its Approved Enterprise and Privileged Enterprise programs could be subject to the statutory Israeli corporate tax rate and the Company could be required to refund a portion of the tax benefits already received, with respect to such programs. As of December 31, 2011, management believes that the Company is in compliance with all the conditions required by the Law.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME (Cont.)

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

As of December 31, 2011, approximately $ 284,000 is tax-exempt attributable to its various Approved and Privileged Enterprise programs. If such tax exempt income is distributed (other than in respect of the Approved Enterprise programs upon the complete liquidation of the Company), it would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%) and an income tax liability of approximately $ 56,000 would be incurred as of December 31, 2011.

During December 2010, the Law for Economic Policy for 2011 and 2012 (Amended Legislation) was passed, and among other things, amended the Law, ("the Amendment") effective January 1, 2011. According to the Amendment, the benefit tracks in the Investment Law were modified and a flat tax rate applies to the Company's entire preferred income. The Company will be able to opt to apply (the waiver is non-recourse) the Amendment and from then on it will be subject to the amended tax rates as follows: 2011 and 2012 - 15%, 2013 and 2014 - 12.5% and in 2015 and thereafter - 12%.

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

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

b. Income taxes on non-Israeli subsidiaries:

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

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- TAXES ON INCOME (Cont.)

c. Net operating loss carryforward:

As of December 31, 2011, certain subsidiaries had tax loss carry-forwards totaling approximately $ 122,500 which can be carried forward and offset against taxable income with expiration dates ranging from 2012 and onwards. Approximately $ 77,300 of these carry-forward tax losses have no expiration date. The balance expires between 2012 and 2029.

Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses increasing taxes before utilization.

d. Deferred tax assets and liabilities:

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

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Deferred tax assets: | | |
| Net operating losses carryforward | $ 30,164 | $ 32,294 |
| Acquired intangibles | 1,573 | 2,277 |
| Share based payments | 7,037 | 7,423 |
| Other | 8,400 | 6,995 |
| Deferred tax assets before valuation allowance | 47,174 | 48,989 |
| Valuation allowance | (19,987 ) | (21,365 ) |
| Deferred tax assets | 27,187 | 27,624 |
| Deferred tax liabilities: | | |
| Acquired intangibles | (39,742 ) | (35,281 ) |
| Deferred tax liabilities, net | $ (12,555 ) | $ (7,657 ) |

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

NOTE 13:- TAXES ON INCOME (Cont.)

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Current deferred tax assets | $ 10,405 | $ 6,798 |
| Long-term deferred tax assets | 5,066 | 5,669 |
| Current deferred tax liabilities | (260 ) | (419 ) |
| Long-term deferred tax liabilities | (27,766 ) | (19,705 ) |
| | | |
| Deferred tax liabilities, net | $ (12,555 ) | $ (7,657 ) |

Long-term deferred tax assets are included within other long-term assets in the balance sheets. Current deferred tax liabilities are included within accrued expenses and other liabilities in the balance sheets.

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

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

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Income before taxes on income, as reported in the consolidated statements of income | $ 68,884 | $ 58,033 | $ 45,796 |
| | | | |
| Statutory tax rate in Israel | 24 % | 25 % | 26 % |
| Approved and Privileged Enterprise benefits *) | (8.9 )% | (9.8 )% | (10.1 )% |
| Changes in valuation allowance | (0.5 )% | (2.5 )% | 0.1 % |
| Earnings taxed under foreign law | 1.9 % | 0.3 % | (4.5 )% |
| Other | 0.4 % | 3.1 % | (4.9 )% |
| | | | |
| Effective tax rate | 16.9 % | 16.1 % | 6.6 % |
| | | | |
| *) Net earnings per ordinary share - amounts of the benefit resulting from the "Approved and Privileged Enterprise" status | | | |
| Basic | $ 0.10 | $ 0.09 | $ 0.08 |
| | | | |
| Diluted | $ 0.10 | $ 0.09 | $ 0.07 |

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

NOTE 13:- TAXES ON INCOME (Cont.)

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

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Domestic | $ 46,093 | $ 38,404 | $ 37,976 |
| Foreign | 22,791 | 19,629 | 7,820 |
| | $ 68,884 | $ 58,033 | $ 45,796 |

g. Taxes on income are comprised as follows:

| | | | |
|---|---|---|---|
| Current | $20,371 | $14,239 | $10,024 |
| Deferred | (8,750 ) | (4,913 ) | (6,984 ) |
| | $11,621 | $9,326 | $3,040 |
| Domestic | $4,999 | $4,180 | $4,255 |
| Foreign | 6,622 | 5,146 | (1,215 ) |
| | $11,621 | $9,326 | $3,040 |

h. Uncertain tax positions:

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

| | December 31, 2011 | 2010 |
|---|---|---|
| Uncertain tax positions, beginning of year | $ 36,029 | $ 31,896 |
| Uncertain tax positions acquired during the year | - | 294 |
| Increases in tax positions for prior years | 936 | - |
| Decreases in tax positions for prior years | - | (305 ) |
| Increases in tax positions for current year | 7,448 | 8,716 |
| Settlements | (978 ) | (4,572 ) |
| Uncertain tax positions, end of year | $ 43,435 | $ 36,029 |

Unrecognized tax benefits included $ 43,275 of tax benefits, which if recognized, would reduce the Company's annual effective tax rate. The Company has further accrued $ 2,227 due to interest related to uncertain tax positions as of December 31, 2011.

As of December 31, 2011, the Company is subject to Israeli income tax audits for the tax years 2006 through 2011, to U.S. federal income tax audits for the tax years of 2003 through 2011 and to other income tax audits for the tax years of 2006 through 2011.

NOTE 14:- SHAREHOLDERS' EQUITY

a. The ordinary shares of the Company are traded on the Tel-Aviv Stock Exchange and its American Depositary Shares ("ADS's") are traded on NASDAQ.

b. Share option plans:

In 2003, the Company adopted the 2003 Stock Option Plan ("the 2003 Option Plan"). Under the 2003 Option Plan, employees and officers of the Company may be granted options to acquire ordinary shares. The options to acquire ordinary shares are granted at an exercise price of not less than the fair market value of the ordinary shares on the grant date, subject to certain exceptions, which may be determined by the Company's Board of Directors. Generally, under the terms of the 2003 Option Plan, 25% of the stock options granted become exercisable on the first anniversary of the date of grant and 6.25% become exercisable once every quarter during the subsequent three years. Stock options expire six years after the date of grant.

Pursuant to the terms of the acquisitions of Actimize Ltd., Orsus Solutions Ltd, e-Glue Software Technologies Inc. and Fizzback, the Company assumed or replaced unvested options, Restricted Stock Awards ("RSA's") and Restricted Stock Units (“RSU's”) and converted them into NICE options, RSA's and RSU's, based on the agreed exchange ratio. Each assumed option, RSA and RSU is subject to the same terms and conditions, including vesting and timing of exercisability, as applied to any such option, RSA and RSU immediately prior to the acquisition.

In June 2008, the Company adopted the 2008 Share Incentive Plan ("the 2008 Plan"), to provide incentives to employees, directors, consultants and/or contractors by rewarding performance and encouraging behavior that will improve the Company's profitability. Under the 2008 Plan, the Company's employees, directors, consultants and/or contractors may be granted any equity-related award, including any type of an option to acquire the Company's ordinary shares and/or share appreciation right and/or share and/or restricted share and/or restricted share unit and/or other share unit and/or other share-based award and/or other right or benefit under the 2008 Plan (each an "Award"). The options to acquire ordinary shares are granted at an exercise price of not less than the fair market value of the ordinary shares on the date of the grant, subject to certain exceptions which may be determined by the Company's Board of Directors, including in some cases options granted with an exercise price at par value.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

Generally, under the terms of the 2008 Plan, 25% of an Award granted become exercisable on the first anniversary of the date of grant and 6.25% become exercisable once every quarter during the subsequent three years. Specifically with respect to restricted share units and par value options, unless determined otherwise by the Board of Directors, 25% of the restricted share units granted become vested on each of the four consecutive annual anniversaries following the date of grant. Awards with a vesting period expire six years after the date of grant. The 2008 Plan provides that the maximum number of shares that may be subject to Awards granted under the 2008 Plan shall be an amount per calendar year, equal to 3.5% of the Company's issued and outstanding share capital as of December 31 of the preceding calendar year. Such amount is reset for each calendar year.

In December 2010, the Company amended the 2008 Plan, such that: (i) options are granted at an exercise price equal to the average of the closing prices of one ordinary share, as quoted on the NASDAQ market, during the 30 consecutive calendar days preceding the date of grant, unless determined otherwise by the administrator of the 2008 Plan (including in some cases options granted with an exercise price equal to the nominal value of an ordinary share), and (ii) options granted with an exercise price equal to the nominal value of an ordinary share shall have a vesting schedule identical to that of restricted share units, as indicated above.

The fair value of the Company's stock options granted to employees and directors for the years ended December 31, 2011, 2010 and 2009 was estimated using the following assumptions:

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Expected volatility | 34.3%-43.8% | 42.8%-48.4% | 42.6%-47.7% |
| Weighted average volatility | 43.02% | 43.7% | 44.7% |
| Risk free interest rate | 0.2%-1.3% | 0.8%-1.8% | 1.2%-2.1% |
| Expected dividend | 0% | 0% | 0% |
| Expected term (in years) | 2.5-3.7 | 2.5-3.7 | 2.5-3.7 |

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's stock options activity and related information for the year ended December 31, 2011, is as follows:

| | Number of options | Weighted-average exercise price | | Weighted-average remaining contractual term (in years) | Aggregate intrinsic value | |
|---|---|---|---|---|---|---|
| Outstanding at January 1, 2011 | 5,227,075 | $ | 22.69 | 4.15 | $ | 63,863 |
| Granted | 1,173,178 | $ | 19.38 | | | |
| Assumed | 148,392 | $ | 0.46 | | | |
| Exercised | (1,291,535) | $ | 20.16 | | | |
| Forfeited | (258,317) | $ | 19.86 | | | |
| Cancelled | (15,252) | $ | 31.76 | | | |
| Outstanding at December 31, 2011 | 4,983,541 | $ | 22.01 | 4.09 | $ | 62,049 |
| Exercisable at December 31, 2011 | 1,940,390 | $ | 25.46 | 3.10 | $ | 17,515 |

On June 15, 2009, the Company repriced 1,020,400 outstanding options that were granted on September 2, 2008, from their previous exercise price of $ 30.25 to an exercise price of $ 22.53. The Company accounted for the re-pricing as a modification and recorded an additional compensation expense, in the amount of $ 2,082, which is recognized over the remaining vesting period or immediately for vested options.

On June 15, 2009, the Company's Board of Directors resolved to approve a privately negotiated transaction with certain executive officers, pursuant to which the Company exchanged 265,000 options granted in 2007 having an exercise price per share ranging between $ 34.00 and $ 39.00 with new options having an exercise price per share equal to $ 22.53. The new options vest in 25% annual increments over a four-year period from the new grant date and will expire six years following the new grant date. The Company accounted for the exchange as a modification and recorded an additional compensation expense, in the amount of $ 1,140, which is recognized over the new vesting period.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

On August 5, 2009, pursuant to a tender offer commenced June 23, 2009, the Company exchanged on a three-for-one basis 1,492,204 options at exercise prices above $ 30 into 311,454 options and 185,932 RSUs (at par value). The new awards vest in 25% annual increments over a four-year period and have a new six-year term. The Company accounted for the exchange of options as a modification and recorded total incremental costs in the amount of $ 4,684 which is recognized over the new vesting period.

The weighted-average grant-date fair value of options granted during the years 2011, 2010 and 2009 was $ 17.99, $ 14.58 and $ 10.43, respectively.

The total intrinsic value of options exercised during the years 2011, 2010 and 2009 was $ 19,295, $ 15,294 and $ 13,457, respectively.

The options outstanding under the Company's stock option plans as of December 31, 2011 have been separated into ranges of exercise price as follows:

| Ranges of exercise price | Options outstanding as of December 31, 2011 | Weighted average remaining contractual Term (Years) | Weighted average exercise price $ | Options exercisable as of December 31, 2011 | Weighted average exercise price of options exercisable $ |
|---|---|---|---|---|---|
| $ 0.02 | 828 | 1.66 | 0.02 | 828 | 0.02 |
| $ 0.26 | 1,090,915 | 4.95 | 0.26 | 168,955 | 0.26 |
| $ 0.69 | 51,831 | 5.82 | 0.69 | 3,577 | 0.69 |
| $ 2.89 | 7,552 | 1.66 | 2.89 | 7,552 | 2.89 |
| $ 6.00-6.87 | 30,050 | 1.66 | 6.57 | 30,050 | 6.57 |
| $ 12.65-14.60 | 53,460 | 1.66 | 14.21 | 53,460 | 14.21 |
| $ 21.76-32.31 | 3,253,516 | 3.96 | 28.14 | 1,401,906 | 27.78 |
| $ 32.92-34.78 | 495,389 | 3.24 | 34.02 | 274,062 | 34.40 |
| | | | | | |
| | 4,983,541 | 4.09 | 22.01 | 1,940,390 | 25.46 |

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

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's Restricted Stock Awards ("RSA") activity and related information for the year ended December 31, 2011, is as follows:

| | Number of RSA | Weighted average exercise price |
|---|---|---|
| Outstanding at January 1, 2011 | 6,027 | $ 2.07 |
| Vested | (5,988) | $ 2.08 |
| Forfeited | (39) | $ 0.02 |
| | | |
| Outstanding at December 31, 2011 | - | $ - |

A summary of the Company's Restricted Stock Units ("RSU") activity and related information for the year ended December 31, 2011, is as follows:

| | Number of RSU | Weighted average exercise price *) |
|---|---|---|
| Outstanding at January 1, 2011 | 421,579 | NIS 1 |
| Issued | 250,708 | NIS 1 |
| Assumed | 17,303 | NIS 1 |
| Vested | (106,144) | NIS 1 |
| Forfeited | (57,946) | NIS 1 |
| | | |
| Outstanding at December 31, 2011 | 525,500 | NIS 1 |

*)Weighted average exercise price is NIS 1 (par value) which represents approximately $ 0.26.

As of December 31, 2011, there was approximately $ 39,487 of unrecognized compensation expense related to non-vested stock options and restricted stock awards, expected to be recognized over four years.

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

c. Employee Stock Purchase Plan:

Eligible employees under the Employee Stock Purchase Plan ("ESPP") can have between 2% to 10% of their earnings withheld, under certain limitations, to be used to purchase ordinary shares. The price of ordinary shares purchased under the ESPP is equal to 95% of the fair market value of the ordinary shares.

During 2011, 2010 and 2009, employees purchased 16,582, 16,537 and 17,331 shares at average prices of $ 33.88, $ 26.38 and $ 21.59 per share, respectively.

d. Treasury shares:

On February 15, 2011 and on November 2, 2011, the board of directors of the Company authorized a program to repurchase up to $ 100,000 and an additional $ 100,000, respectively of the Company's issued and outstanding ordinary shares and ADRs. Repurchases may be made from time to time in the open market or in privately negotiated transactions and will be in accordance with applicable securities laws and regulations. The timing and amount of the repurchase transactions will be determined by management and may depend on a variety of factors, including market conditions, alternative investment opportunities and other considerations. The program does not obligate the Company to acquire any particular amount of ordinary shares and ADRs and the program may be modified or discontinued at any time without prior notice.

e. Dividends:

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

NOTE 15:- REPORTABLE SEGMENTS AND GEOGRAPHICAL INFORMATION

a. Reportable segments:

The Company operates in three operation-based segments: Customer Interactions Solutions, Security Solutions and Financial Crime and Compliance Solutions and these three segments comprise its reporting units.

Each of the operational segments is overseen by their respective segment managers. The segment managers report directly to the Chief Operating Decision Maker ("CODM") with respect to their operating results.

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- REPORTABLE SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

The Company's segments are engaged in business activities for which they earn revenues and incur expenses, their results are reviewed by the CODM and discrete financial information is available.

The following tables present the financial information of the Company's reportable segments.

| | Year ended December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Customer Interactions Solutions | Security Solutions | Financial Crime and Compliance Solutions | Not allocated | Total |
| Revenues | $ 477,572 | $ 191,852 | $ 124,407 | $ - | $ 793,831 |
| Operating income (loss) | $ 141,771 | $ 33,926 | $ (6,662 ) | $ (110,007) | $ 59,028 |

| | Year ended December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Customer Interactions Solutions | Security Solutions | Financial Crime and Compliance Solutions | Not allocated | Total |
| Revenues | $ 403,940 | $ 165,998 | $ 119,513 | $ - | $ 689,451 |
| Operating income (loss) | $ 126,537 | $ 15,515 | $ 71 | $ (93,071 ) | $ 49,052 |

| | Year ended December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Customer Interactions Solutions | Security Solutions | Financial Crime and Compliance Solutions | Not allocated | Total |
| Revenues | $ 363,576 | $ 147,863 | $ 71,676 | $ - | $ 583,115 |
| Operating income (loss) | $ 117,648 | $ 29,996 | $ (15,733 ) | $ (93,712 ) | $ 38,199 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- REPORTABLE SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

The following presents long-lived assets of December 31, 2011 and 2010, based on operational segments:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Customer Interactions Solutions | 14,535 | 10,464 |
| Security Solutions | 4,533 | 4,109 |
| Financial Crime and Compliance Solutions | 7,319 | 5,997 |
| Non-allocated | 1,912 | 1,444 |
| | | |
| | 28,299 | 22,014 |

b. Geographical information:

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Americas | $ 499,162 | $ 429,889 | $ 365,817 |
| EMEA *) | 196,640 | 182,805 | 150,373 |
| APAC **) | 98,029 | 76,757 | 66,925 |
| | | | |
| | $ 793,831 | $ 689,451 | $ 583,115 |

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

The following presents long-lived assets of December 31, 2011 and 2010, based on geographical segments:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Americas | $ 7,735 | $ 5,955 |
| EMEA | 19,019 | 15,227 |
| APAC | 1,545 | 832 |
| | | |
| | $ 28,299 | $ 22,014 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 16:- SELECTED STATEMENTS OF INCOME DATA

a. Research and development costs, net:

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Total costs | $ 113,671 | $ 102,208 | $ 82,463 |
| Less - grants and participations | (3,394 ) | (3,814 ) | (3,766 ) |
| Less - capitalization of software development costs | (1,150 ) | (1,311 ) | (1,315 ) |
| | $ 109,127 | $ 97,083 | $ 77,382 |

b. Financial income and other, net:

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Financial income: | | | |
| Interest and amortization/accretion of premium/discount on marketable securities | $ 8,357 | $ 8,889 | $ 9,076 |
| Gain on forward contracts | 9,902 | - | - |
| Realized gain on marketable securities | 1,124 | 1,435 | 984 |
| Interest | 3,154 | 1,787 | 1,962 |
| Foreign currency translation | 1,725 | 927 | 1,283 |
| | 24,262 | 13,038 | 13,305 |
| Financial expenses: | | | |
| Realized loss on marketable securities | (333 ) | (238 ) | (1,062 ) |
| Interest | (930 ) | (250 ) | (705 ) |
| Foreign currency translation | (11,872 ) | (2,109 ) | (2,672 ) |
| Other | (1,109 ) | (1,306 ) | (1,154 ) |
| | (14,244 ) | (3,903 ) | (5,593 ) |
| Other expenses, net | (162 ) | (154 ) | (115 ) |
| | $ 9,856 | $ 8,981 | $ 7,597 |

NICE SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

c. Net earnings per share:

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

1.Numerator:

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Net income available to ordinary shareholders | $ 57,263 | $ 48,707 | $ 42,756 |

2.Denominator (in thousands):

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Denominator for basic net earnings per share - | | | |
| Weighted average number of shares | 62,924 | 62,652 | 61,395 |
| Effect of dilutive securities: | | | |
| Add - employee stock options and RSU | 1,317 | 1,480 | 1,095 |
| Denominator for diluted net earnings per share - adjusted weighted average shares | 64,241 | 64,132 | 62,490 |

NOTE 17:- SUBSEQUENT EVENTS

On February 7, 2012, the Company completed the acquisition of all of the outstanding shares of Merced Systems, Inc. ("Merced"), a leading provider of performance management solutions that drive business execution in sales and service functions. The Company acquired Merced for a total consideration of approximately $ 150,000, net of cash acquired (approximately $ 22,000). The Company will pay Merced an additional amount of up to $ 20,000 in cash subject to Merced meeting certain performance targets. It is expected that integrating Merced's and the Company’s capabilities will create a closed-loop Performance Management solution.

SIGNATURES

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

NICE-SYSTEMS LTD.

By: /s/ Zeev Bregman
Zeev Bregman
President and Chief Executive Officer

Date: March 29, 2012