

Allot Communications Ltd.  
Form 20-F  
March 23, 2017

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2016

OR

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

OR

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

Date of event requiring this shell company report.....

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

Commission File Number 001-33129

ALLOT COMMUNICATIONS LTD.  
(Exact Name of Registrant as specified in its charter)

ISRAEL  
(Jurisdiction of incorporation or organization)

22 Hanagar Street  
Neve Ne'eman Industrial Zone B  
Hod-Hasharon 4501317

Israel

(Address of principal executive offices)

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

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Ordinary Shares, par value ILS 0.10 per share	The NASDAQ Stock Market, LLC

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2016: 33,057,719 ordinary shares, ILS 0.10 par value per share

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

Yes      No

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

Yes      No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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

Yes   No

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

Yes   No

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

Large accelerated filer   Accelerated filer   Non-accelerated filer

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

U.S. GAAP	International Financial Reporting Standards as issued by the International Accounting Standards Board	Other
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If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18

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

Yes            No

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## PRELIMINARY NOTES

### Terms

As used herein, and unless the context suggests otherwise, the terms “Allot,” “Company,” “we,” “us” or “ours” refer to Allot Communications Ltd.

### Cautionary Note Regarding Forward-Looking Statements

In addition to historical facts, this annual report on Form 20-F contains forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended (the “Securities Act”), Section 21E of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”) and the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, potential market opportunities and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by terms such as “anticipates,” “believes,” “could,” “seeks,” “estimates,” “expects,” “intends,” “may,” “plans,” “potential,” “predicts,” “should,” “will,” “would” or similar expressions that convey uncertainty of future events or outcomes and the negatives of those terms. These statements include but are not limited to:

- statements regarding projections of capital expenditures;
- statements regarding competitive pressures;
- statements regarding expected revenue growth;
  - statements regarding the expected growth in demand of our products
- statements regarding trends in mobile networks, including the development of a digital lifestyle, over-the-top applications, the need to manage mobile network traffic and cloud computing, among others;
- statements regarding our ability to develop technologies to meet our customer demands and expand our product and service offerings;
  - statements regarding the acceptance and growth of our value-added services by our customers;
- statements regarding the expected growth in the use of particular broadband applications;
- statements as to our ability to meet anticipated cash needs based on our current business plan;
  - statements as to the impact of the rate of inflation and the political and security situation on our business;
  - statements regarding the price and market liquidity of our ordinary shares;
- statements as to our ability to retain our current suppliers and subcontractors; and

statements regarding our future performance, sales, gross margins, expenses (including stock-based compensation expenses) and cost of revenues.

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These statements may be found in the sections of this annual report on Form 20-F entitled “ITEM 3: Key Information—Risk Factors,” “ITEM 4: Information on Allot,” “ITEM 5: Operating and Financial Review and Prospects,” “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations” and elsewhere in this annual report, including the section of this annual report entitled “ITEM 4: Information on Allot—Business Overview—Overview” and “ITEM 4: Information on Allot—Business Overview—Industry Background,” which contain information obtained from independent industry sources. Actual results could differ materially from those anticipated in these forward-looking statements due to various factors, including all the risks discussed in “ITEM 3: Key Information—Risk Factors” and elsewhere in this annual report.

All forward-looking statements in this annual report reflect our current views about future events and are based on assumptions and are subject to risks and uncertainties that could cause our actual results to differ materially from future results expressed or implied by the forward-looking statements. Many of these factors are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. Unless we are required to do so under U.S. federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

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## PART I

## ITEM 1: Identity of Directors, Senior Management and Advisers

Not applicable.

## ITEM 2: Offer Statistics and Expected Timetable

Not applicable.

## ITEM 3: Key Information

## A. Selected Financial Data

You should read the following selected consolidated financial data in conjunction with “ITEM 5: Operating and Financial Review and Prospects” and our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. The consolidated statements of operations data for the years ended December 31, 2014, 2015 and 2016 and the consolidated balance sheet data as of December 31, 2015 and 2016 are derived from our audited consolidated financial statements included in “ITEM 18: Financial Statements,” which have been prepared in accordance with generally accepted accounting principles in the United States. The consolidated statements of operations for the years ended December 31, 2012 and 2013 and the consolidated balance sheet data as of December 31, 2012, 2013 and 2014 have been derived from our audited consolidated financial statements which are not included in this annual report.

	Year ended December 31,				
	2012	2013	2014	2015	2016
	(in thousands, except per share and share data)				
Consolidated Statements of Operations:					
Revenues:					
Products	\$77,127	\$66,318	\$77,240	\$62,642	\$54,432
Services	27,625	30,227	39,946	37,325	35,937
Total revenues	104,752	96,545	117,186	99,967	90,369
Cost of revenues(1):					
Products	26,857	20,572	27,389	26,707	20,401
Services	4,180	6,246	7,350	6,720	7,494
Expenses related to the settlement of the Israel Innovation Authority(2)					
	15,886	-	-	-	-
Total cost of revenues	46,923	26,818	34,739	33,427	27,895
Gross profit	57,829	69,727	82,447	66,540	62,474
Operating expenses:					
Research and development, gross	24,915	28,073	29,998	27,674	24,827
Less grant participation	2,855	1,051	984	1,252	606
Research and development, net(1)	22,060	27,022	29,014	26,422	24,221
Sales and marketing(1)	34,127	39,817	44,599	43,318	35,290
General and administrative(1)	10,664	9,952	11,941	12,702	9,812
Total operating expenses	66,851	76,791	85,554	82,442	69,323
Operating income (loss)	(9,022)	(7,064)	(3,107)	(15,902)	(6,849)
Financing income (expenses), net	1,358	727	660	(584)	1,059
Income (loss) before income tax expenses (benefit)	(7,664)	(6,337)	(2,447)	(16,486)	(5,790)
Income tax expenses (benefit)	(926)	120	50	3,356	2,204

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Net income (loss)	\$ (6,738	) \$ (6,457	) \$ (2,497	) \$ (19,842	) \$ (7,994	)
Basic net earnings (loss) per share	\$ (0.21	) \$ (0.20	) \$ (0.08	) \$ (0.59	) \$ (0.24	)
Diluted net earnings (loss) per share	\$ (0.21	) \$ (0.20	) \$ (0.08	) \$ (0.59	) \$ (0.24	)
Weighted average number of shares used in computing basic net earnings (loss) per share	31,959,921	32,680,766	33,143,168	33,419,917	33,202,309	
Weighted average number of shares used in computing diluted net earnings (loss) per share	31,959,921	32,680,766	33,143,168	33,419,917	33,202,309	

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(1) Includes stock-based compensation expense related to options and restricted stock units, or RSUs, granted to employees and others as follows:

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	Year ended December 31,				
	2012	2013	2014	2015	2016
	(in thousands)				
Cost of revenues	\$222	\$368	\$353	\$324	\$367
Research and development expenses, net	1,186	1,666	1,919	1,637	1,240
Sales and marketing expenses	2,060	3,106	3,322	2,802	1,833
General and administrative expenses	1,349	2,591	2,501	2,407	1,701
Total	\$4,817	\$7,731	\$8,095	\$7,170	\$5,141

(2) Represents the full balance of the contingent liability related to grants received, which was paid in 2013.

	At December 31,				
	2012	2013	2014	2015	2016
	(in thousands)				
Consolidated balance sheet data:					
Cash and cash equivalents	\$50,026	\$42,813	\$19,180	\$15,470	\$23,326
Short-term deposits and restricted deposits	78,188	38,000	59,000	42,903	29,821
Marketable securities	14,841	40,798	54,271	64,921	60,507
Working capital	131,598	133,362	138,174	126,756	123,980
Total assets	221,791	199,257	212,948	208,215	190,940
Total liabilities	52,670	29,330	37,968	44,810	33,637
Accumulated deficit	(67,385 )	(73,842 )	(76,339 )	(96,181 )	(104,175 )
Share capital	761	774	819	837	843
Total shareholders' equity	169,121	169,927	174,980	163,405	157,303

#### B. Capitalization and Indebtedness

Not applicable.

#### C. Reasons for Offer and Use of Proceeds

Not applicable.

#### D. Risk Factors

Our business involves a high degree of risk. You should consider carefully the risks described below, together with the financial and other information contained in this annual report and our other filings with the SEC. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our ordinary shares would likely decline and you might lose all or part of your investment. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

## Risks Relating to Our Business

We have a history of losses and may not be able to achieve or maintain profitability in the future.

We have a history of net losses in all fiscal years since our inception, other than in 2006 and 2011. We had a net loss of \$8.0 million in 2016, resulting mainly from a decrease in both products revenues and services revenues. We had a net loss of \$19.8 million in 2015, resulting mainly from impairment charge of \$5.8 million, tax expenses which amounted to \$3.4 million (including \$2.7 million of deferred tax asset and pre-paid tax expenses write-off) and a decrease in product revenues. We had a net loss of \$2.5 million in 2014, resulting from an inventory write-off of approximately \$3.4 million due to launches of newer versions of our products, which rendered certain products in our inventory obsolete. We can provide no assurance that we will be able to achieve or maintain profitability, and we may incur losses in the future if we do not generate sufficient revenues.

Our revenues and business may be adversely affected if we do not effectively compete in the markets in which we operate.

We compete against large companies in a rapidly evolving and highly competitive sector of the networking technology and security markets, which offer, or may offer in the future, competing technologies, including partial or alternative solutions to operators' challenges, and which, similarly to us, intensely pursue the largest service providers (referred to as Tier 1 operators). Our ability to effectively compete in these markets may be limited since our competitors may have greater financial resources, significant market share and established relationships with operators and distribution channels.

Our Deep Packet Inspection (DPI) technology enabled offerings face significant competition from router and switch infrastructure companies that integrate functionalities into their platforms, addressing some of the same types of issues that our products are designed to address. In addition, increased network encryption could limit the ability of our DPI solutions to provide analytic information.

Our security products are offered to operators and are deployed in their networks, enabling them to provide security services to their end customers. Such products face significant competition from companies that directly approach end customers and offer them security applications to be installed on their devices; companies that approach the business enterprise sector through distribution channels and offer cloud security products; and companies that offer security products bundled with other products. By offering our security products to operators that provide security services to both business enterprises and individual end customers, we aim to expand the reach of our products. However, such business model may prove to be slower to market or less effective than our competitors' models, in which case our business may be harmed.

Certain of our current direct competitors are substantially larger than we are and have significantly greater financial, sales and marketing, technical, manufacturing and other resources. As the intelligent broadband solutions market has grown, including the markets for DPI enabled solutions for mobile networks and for security products, new competitors have entered and may continue to enter the market. Furthermore, our market may be subject to industry consolidation, as companies attempt to maintain or strengthen their positions in our evolving industry. For example, some of our current and potential competitors have made acquisitions or have announced new strategic alliances designed to position them to provide many of the same products and services that we provide to both the service provider and enterprise markets. Industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers, may cause price reductions, reduced gross margins and loss of market share.

Therefore, if our competitors announce new products, services or enhancements that better meet the needs of customers or changing industry requirements, offer alternative methods to achieve customer objectives or implement

faster go to market strategies, if our business model proves less effective than those of our competitors, if new competitors enter the market, or if industry consolidation results in stronger competitors with wider range of product offerings and greater financial resources, our ability to effectively compete may be harmed, which could have a material adverse effect on our business, financial condition or results of operations.

We depend on one or more significant customers and the loss of any such significant customer or a significant decrease in business from any such customer could harm our results of operations.

We derived 44%, 37%, and 42% of our total revenues in 2014, 2015 and 2016, respectively, from two Tier 1 mobile and fixed operators. In addition, revenues from individual customers may fluctuate from time to time based on the timing and the terms under which orders are received and the duration of the delivery and implementation of such orders, potentially resulting in decreases in revenues from such customers. The loss of any significant customer or a significant decrease in business from any such customer could have a material adverse effect on our revenues, results of operations and financial condition.

Demand for our products may be impacted by government regulation of the telecommunications industry.

Service providers are subject to government regulation in a number of jurisdictions in which we sell our products. There are several proposals in the United States, Europe and elsewhere for regulating service providers' ability to prioritize applications in their networks. Advocates for regulating this industry claim that collecting premium fees from certain "preferred" applications would distort the market for Internet applications in favor of larger and better-funded content providers. They also claim that this would impact end-users who already purchased broadband access only to experience response times that differ based on content provider. Opponents believe that content providers who support bandwidth-intensive applications should be required to pay service providers a premium in order to support further network investments. On June 12, 2015, the Open Internet Report and Order on Remand, Declaratory Ruling, and Order (the "Open Internet Order"), issued by the United States Federal Communications Commission (the "FCC"), went into effect. The Open Internet Order sets forth rules, grounded, among others, on Title II of the Communications Act of 1934; the Open Internet Order regulates both fixed and mobile Internet Service Providers (ISPs) and prohibits them, subject to reasonable network management, from blocking and/or throttling of lawful content, applications, services, or non-harmful devices, and from unreasonably interfering or disadvantaging of (i) end users' ability to select, access service of the lawful Internet content, applications, services, or devices of their choice or (ii) edge providers' ability to make lawful content, applications, services, or devices available to end users. The Open Internet Order also prohibits paid prioritization of content. On April 30, 2016, Regulation (EU) 2015/2120 of the European Parliament and of the Council came into effect, setting forth the first EU-wide Net Neutrality ("Open Internet") rules. Under these rules, blocking, throttling and discrimination of internet traffic by ISPs is prohibited in the EU, with three exceptions: (i) compliance with legal obligations; (ii) integrity of the network; and (iii) congestion management in exceptional and temporary situations. Under these rules, there can be no prioritization of traffic in the internet access service. However, equal treatment permits reasonable day-to-day traffic management according to objectively justified technical requirements, and which must be independent of the origin or destination of the traffic and of any commercial considerations.

However, these rules also allow internet access providers, as well as content and applications providers, to offer special services with specific quality requirements, (provided the Open Internet is not negatively affected by the provision of these services). Such specialized services cannot be a substitute to internet access services, can only be provided if there is sufficient network capacity to provide them in addition to any internet access service and must not be to the detriment of the availability or general quality of internet access services for end-users.

Such regulation of both fixed and mobile ISPs may limit ISPs' ability to manage, prioritize and monetize their network. Additionally, these regulations may attract growing public debate and attention of regulators in other jurisdictions we operate in. Demand from service providers, in affected jurisdictions, for the traffic management and subscriber management features of our products may be adversely affected by such regulations. A decrease in demand for these features could adversely impact sales of our products and could have a material adverse effect on our business, financial condition or result of operations.



We need to increase the functionality of our products and offer additional features and products in order to maintain or increase our profitability.

The commoditization of DPI technology and the introduction of competitive features and value added services will result in a decrease of the average sale prices of our DPI technology enabled products.

The market in which we operate is highly competitive and unless we continue to enhance the functionality of our products, add additional features and offer additional products, our competitiveness may be harmed.

We endeavor to enhance our products by offering higher system speeds, additional features and value-added products, such as security and parental control products, among other value added products and support for additional applications and enhanced reporting tools. We also continuously endeavor to assure our solutions comply with contemporary network and software architectures such as virtualized network services (NFV).

Our value-added products offer customers additional tools to increase the efficiency of their networks or to help them offer additional services to their end customers and derive additional revenues from their end customers. The industry and market for our value added products, are still developing and are affected, among others, by trends and changes in internet broadband traffic, including changes in methods used by various content providers and broadband applications and evolution of network security threats.

We cannot provide any assurance that demand for our additional features and value added products will continue or grow, or that we will be able to generate revenues from such sales at the levels we anticipate or at all. Any inability to sell or maintain our additional features and value-added products may lead to commercial disputes with our customers and to lengthy implementation processes and increased spending on technical solutions, all of which may negatively impact our results of operations.

Our revenues and business will be harmed if we do not keep pace with changes in broadband applications, network security threats and with advances in technology, or if we do not achieve widespread market acceptance, including through significant investments.

We will need to invest heavily in the continued development of our technology in order to keep pace with rapid changes in applications, increased broadband network speeds, network security threats and with our competitors' efforts to advance their technology. Our ability to develop and deliver effective product offerings depends on many factors, including identifying our customers' needs, technical implementation of new services and integration of our value-added products with our customers' existing network infrastructure. While we will continue to introduce innovative value-added products, we cannot provide any assurance that any new products we introduce will achieve the same degree of success that we have with our existing products. Designers of broadband applications and distributors of various network security threats that our products identify, manage or mitigate, are using increasingly sophisticated methods to avoid detection and management and/or mitigation by network operators.

Even if our products successfully identify a particular application, it is sometimes necessary to distinguish between different types of traffic belonging to a single application. Accordingly, we face significant challenges in ensuring that we identify new applications and new versions of current applications as they are introduced without impacting network performance, especially as networks become faster. This challenge is increased as we seek to expand sales of our products to new geographic territories because the applications vary from country to country and region to region.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. To compete, we need to achieve widespread market acceptance.

Alternative technologies could achieve widespread market acceptance and displace the technology on which we have based our product architecture.

Our business and revenues will be adversely affected if we fail to develop enhancements to our products, in order to keep pace with changes in broadband applications, network security threats and advances in technology. We can give no assurance that our technological approach will achieve broad market acceptance or that other technology or devices will not supersede our technology and products.

A failure of our products may adversely affect the operation of our customers' live networks, which could harm our reputation, brand position, and financial condition.

Our products are, generally, installed in line, as part of our customers' networks. We endeavor to avoid any interruption to the regular operation of such networks, including, by performing certain tasks during predetermined maintenance windows, and implementing a system bypass, in the event of malfunctions. However, in certain cases, a failure of our products may result in our customers experiencing loss of functionality, denial of service and access, disconnection of live traffic on their networks, loss of security protection, end user dissatisfaction and loss of revenues. Such failure of our products, may cause commercial disputes with our customers and adversely affect our reputation.

Sales of our products to large service providers can involve a lengthy sales cycle, which may impact the timing of our revenues and result in us expending significant resources without making any sales.

Our sales cycles to large service providers, including carriers, mobile operators and cable operators, are generally lengthy because these end-customers consider our products to be capital equipment and undertake significant testing to assess the performance of our products within their networks. Furthermore, many of our product and service arrangements with our customers provide that the final acceptance of a product or service may be specified by the customer. In such instances, we do not recognize the revenue until all acceptance criteria have been met. As a result, we often invest significant time from initial contact with a large service provider until it decides to incorporate our products into its network, and we may not be able to recognize the revenue from a customer until all acceptance criteria have been satisfied. We may also expend significant resources in attempting to persuade large service providers to incorporate our products into their networks without success. Even after deciding to purchase our products, the initial network deployment of our products by a large service provider may last up to one year and in certain instances up to one and a half years. If a competitor succeeds in convincing a large service provider to adopt that competitor's product, it may be difficult for us to displace the competitor because of the cost, time, effort and perceived risk to network stability involved in changing solutions. As a result, we may incur significant expenses without generating any sales, which could adversely affect our profitability.

The complexity and scope of the solutions and services we provide to larger service providers are increasing, and such larger projects entail greater operational risk and an increased chance of failure.

The complexity and scope of the solutions and services we provide to larger service providers are increasing. The larger and more complex such projects are, the greater the operational risks associated with them. These risks include, but are not limited to, the failure to meet high customization requirements of service providers, the failure to fully integrate our products into the service provider's network or with third-party products, our dependence on subcontractors and partners and on effective cooperation with third-party vendors for the successful and timely completion of such projects. If we encounter any of these risks, we may incur higher costs in order to complete the project and may be subject to contractual penalties resulting in lower profitability. In addition, the project may demand more of our management's time than was originally planned, and our reputation may be adversely impacted.

We depend on third parties to market, sell, install and provide initial technical support for our products for a material portion of our business.

We depend on third-party channel partners, such as distributors, resellers, original equipment manufacturers, or OEMs, and system integrators, to market and sell a material portion of our products to end-customers. In 2016, approximately 41% of our revenues were derived from channel partners. Our channel partners are also responsible for installing our products and providing initial customer support for them. As a result, we depend on the ability of our channel partners to successfully market and sell our products to these end-customers. We also depend on our ability to maintain our relationships with existing channel partners and to develop relationships with new channel partners in key markets. We can give no assurance that our channel partners will market our products effectively, receive and

fulfill customer orders for our products on a timely basis or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. In addition, any failure by our channel partners to provide adequate initial support to end-customers could result in customer dissatisfaction with us or our products, which could result in a loss of customers, harm our reputation and delay or limit market acceptance of our products. Our products are complex and it takes time for a new channel partner to gain experience in the operation and installation of these products. Therefore, it may take a period of time before a new channel partner can successfully market, sell and support our products if an existing channel partner ceases to sell our products. Additionally, our agreements with channel partners are generally not exclusive and our channel partners may market and sell products that compete with our products. Our agreements with our distributors and resellers are usually for an initial one-year term and following the expiration of this term, can be terminated by either party. We can give no assurance that these agreements will remain in effect, and any termination of one or more of the agreements may adversely affect our profitability and results of operations.

We are subject to certain regulatory regimes that may affect the way that we conduct business internationally, and our failure to comply with applicable laws and regulations could adversely affect our reputation and result in penalties and increased costs.

We are subject to a complex system of laws and regulations related to international trade, including economic sanctions and export control laws and regulations. It is our policy not to make direct or indirect prohibited sales of our products, including into countries sanctioned under laws to which we are subject, and to contractually limit the territories into which our channel partners may sell our products. Nevertheless, several years ago one of our channel partners sold certain of our products (designed for the enterprise market) outside of its contractually designated territory, including into a sanctioned country, and we subsequently determined that our contract management protocol for authorizing channel partner sales was not adequately followed in that instance.

Because depend on our distributors and agents outside of Israel for compliance and adherence to local laws and regulations, significant political or regulatory developments in those jurisdictions, such as those stemming from the recent change in the presidential administration in the U.S. or the U.K.'s "Brexit" referendum are difficult to predict and may have a material adverse effect on us. For example, in the United States, the new presidential administration has expressed support for and may implement greater restrictions on free trade and increase tariffs on goods imported into the United States, as well as a comprehensive tax reform, including in corporate and income taxation. We cannot predict whether quotas, duties, tariffs, taxes or other similar restrictions will be imposed by the United States or other countries upon the import or export of our products in the future. However, changes in U.S. political, regulatory and economic conditions or in its policies governing international trade and foreign manufacturing and investment in the U.S. could adversely affect our sales in the U.S.

In the United Kingdom, a recent referendum was held in which voters approved an exit from the E.U., commonly referred to as "Brexit." On February 8, 2017, the U.K.'s House of Commons approved a bill authorizing the government to start exit talks with the E.U. The impact on us from Brexit will depend, in part, on the outcome of tariff, trade, regulatory and other negotiations. Brexit could also lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. Any of these developments could adversely affect our sales in Europe.

We are also subject to the U.S. Foreign Corrupt Practices Act and may be subject to similar worldwide anti-bribery laws that generally prohibit companies and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. Some of the countries in which we operate have experienced governmental corruption to some degree and, in certain circumstances, strict compliance with anti-bribery laws may conflict with local customs and practices.

Despite our compliance and training programs, we cannot be certain that our procedures will be sufficient to ensure consistent compliance with all applicable international trade and anti-corruption laws, or that our employees or channel partners will strictly follow all policies and requirements to which we subject them. Any alleged or actual violations of these laws may subject us to government scrutiny, investigation, debarment, and civil and criminal penalties, which may have an adverse effect on our results of operations, financial condition and reputation.

We depend on our traffic management systems and network management application suites for the substantial majority of our revenues.

In the past few years, we have increased sales of our Value Added Services. However, sales of our traffic management systems continue to account for a major portion of our revenues, and accounted for 57%, 58% and 50% of our total revenues in 2014, 2015 and 2016, respectively. We expect the traffic management systems will continue to account for a considerable portion of our revenues in the immediate future. If we are unable to increase these sales, our business will suffer. In addition, service providers may choose embedded or integrated solutions using routers and switches from larger networking vendors over a standalone solution that we offer. Any factor adversely affecting our ability to sell, or the pricing of or demand for, our traffic management systems and network management system, would severely harm our ability to generate revenues and could have a material adverse effect on our business.

We integrate into or bundle various third-party solutions with our products and may integrate or offer additional third-party solutions in the future. If we lose the right to use such solutions, our sales could be disrupted and we would have to spend additional capital to replace such components.

We integrate various third-party solutions into our products and offer third-party solutions bundled with our products. We may integrate or offer additional third-party solutions in the future. Sales of our products could be disrupted if such third-party solutions were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to spend additional capital to either source alternative third-party solutions, redesign our products to function with alternate third-party solutions or develop substitute components ourselves. As a result, our sales may be delayed and/or adversely affected and we might be forced to limit the features available in our current or future product offerings, which could have a material adverse effect on our business.

Our products are highly technical and any undetected software or hardware errors in our products could have a material adverse effect on our operating results.

Our products are complex and are incorporated into broadband networks, which are a major source of revenue for service providers and support critical applications for subscribers and enterprises. Due to the highly technical nature of our products and variations among customers' network environments, we may not detect product defects until our products have been fully deployed in our customers' networks. Regardless of whether warranty coverage exists for a product, we may be required to dedicate significant technical resources to repair any defects. If we encounter significant errors, we could experience, among other things, loss of major customers, cancellation of orders, increased costs, delay in recognizing revenues and damage to our reputation. We could also face claims for product liability, tort or breach of warranty. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention. In addition, if our business liability insurance is inadequate or future coverage is unavailable on acceptable terms or at all, our financial condition could be harmed.

Demand for our DPI technology enabled products depends, in part, on the rate of adoption of bandwidth-intensive broadband applications, and the impact multiple applications may have on network speed.

Our products are used by service providers and enterprises to monitor and manage bandwidth-intensive applications that cause congestion in broadband networks and impact the quality of experience for users. Demand for our products is driven particularly by growth in applications, which are highly sensitive to network delays and therefore require efficient network management. If the rapid growth in the adoption of such applications does not continue, the demand for our products may be adversely impacted.

Demand for our security products depends, in part, on continued evolution of on-line threat as well as on operators' interest in providing security services to their end customers.

Our security products are used by service providers to offer security services to their end customers, comprising both of business enterprises as well as individual end customers. The demand for these services depends highly on continued evolution and increase of online threats. In the event that such threats decrease, that end customers are not willing to incur the costs of security services and/or in the event that ISPs do not continue to pursue security services to their end customers as a revenue source, demand for our security products may be materially adversely impacted.

We currently depend on a single subcontractor to manufacture and provide hardware warranty support for our Service Gateway platforms and NetEnforcer platforms. If this subcontractor experiences delays, disruptions, quality control problems or a loss in capacity, it could materially and adversely affect our operating results.

We currently depend on a single subcontractor, Flex (Israel) Ltd. (previously Flextronics (Israel) Ltd.), a subsidiary of Flex (previously Flextronics), a global electronics manufacturing services company, to manufacture, assemble, test, package and provide hardware warranty support for our Service Gateway platforms and NetEnforcer platforms. In addition, our agreement with Flex (Israel) requires it to procure and store key components for our products at its facilities. If Flex (Israel) experiences delays, disruptions or quality control problems in manufacturing our products, or if we fail to effectively manage our relationship with Flex (Israel), product shipments may be delayed and our ability to deliver products to customers could be materially and adversely affected. Flex (Israel) may terminate our agreement at any time during the term upon prior notice. We expect that it would take approximately six months to transition the manufacturing of our products to an alternate manufacturer and our inventory of completed products may not be sufficient for us to continue delivering products to our customers on a timely basis during any such transition period. Therefore, the loss of Flex (Israel) could adversely affect our sales and operating results and harm our reputation.

Certain hardware and software components for our products come from single or limited sources and we could lose sales if these sources fail to satisfy our supply requirements or if our customers refuse to implement components from certain sources.

We obtain certain hardware components used in our products from single or limited sources.

Although the abovementioned hardware components are off-the-shelf items, because our systems have been designed to incorporate these specific hardware components, any change to these components due to an interruption in supply or our inability to obtain such components on a timely basis, may require engineering changes to our products before substitute hardware components could be incorporated. Such changes could be costly and result in lost sales particularly to our traffic management systems. The agreements with our suppliers do not contain any minimum supply commitments. If we or our contract manufacturer fail to obtain components in sufficient quantities when required, our business could be harmed.

We obtain certain software components of our security products, from a few limited sources, depending primarily on our customers' preferences. In the event that we are no longer able to source such software components from a particular source, and our customers refuse to implement components from our alternative sources, we may be required to identify an alternative source from which we do not currently acquire such software or develop such software ourselves. This may result in disputes with our customers and/or cancellation or delay of orders, which may materially adversely affect our business.

Our suppliers also sell products to our competitors and may enter into exclusive arrangements with our competitors, stop selling their products or components to us at commercially reasonable prices or refuse to sell their products or components to us at any price. Our inability to obtain sufficient quantities of single-source or limited-sourced components or to develop alternative sources for components or products would harm our ability to maintain and expand our business.





We may expand our business or enhance our technology through acquisitions that could result in diversion of resources and extra expenses. This could disrupt our business and adversely affect our financial condition.

Part of our strategy is to selectively pursue partnerships and acquisitions. We have acquired a number of companies in recent years, including most recently, the acquisition of substantially all of the business and assets of Optenet S.A., a Madrid-based global IT security company, in March 2015. The negotiation of acquisitions, investments or joint ventures, as well as the integration of acquired or jointly developed businesses or technologies, could divert our management's time and resources. Acquired businesses, technologies or joint ventures may not be successfully integrated with our products and operations and we may not realize the intended benefits of these acquisitions. We may also incur future losses from any acquisition, investment or joint venture. In addition, acquisitions could result in:

- substantial cash expenditures;
- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- a decrease in our profit margins; and
- amortization of intangibles and potential impairment of goodwill.

If acquisitions disrupt our operations or result in significant expenditures or liabilities, our business, operating results or financial conditions may suffer.

If we are unable to successfully protect the intellectual property embodied in our technology, our business could be harmed significantly.

Know-how relating to networking protocols, building carrier-grade systems, identifying applications and developing and maintaining security products is an important aspect of our intellectual property. It is our practice to have our employees sign appropriate non-compete agreements when permitted under applicable law. These agreements prohibit our employees who cease working for us from competing directly with us or working for our competitors for a limited period of time. The enforceability of non-compete clauses in certain jurisdictions in which we operate may be limited. Under the current laws of some jurisdictions in which we operate, we may be unable to enforce these agreements and it may thereby be difficult for us to restrict our competitors from gaining the expertise our former employees gained while working for us.

Further, to protect our know-how, we customarily require our employees, distributors, resellers, software testers and contractors to execute confidentiality agreements or agree to confidentiality undertakings when their relationship with us begins. Typically, our employment contracts also include the following clauses: assignment of intellectual property rights for all inventions developed by employees and non-disclosure of all confidential information. We cannot provide any assurance that the terms of these agreements are being observed and will be observed in the future. Because our product designs and software are stored electronically and thus are highly portable, we attempt to reduce the portability of our designs and software by physically protecting our servers through the use of closed networks, which prevent external access to our servers. We cannot be certain, however, that such protection will adequately deter individuals or groups from wrongfully accessing our technology. Monitoring unauthorized use of intellectual property is difficult and some foreign laws do not protect proprietary rights to the same extent as the laws of the United States. We cannot be certain that the steps we have taken to protect our proprietary information will be sufficient. In addition, to protect our intellectual property, we may become involved in litigation, which could result in substantial expenses, divert the attention of management, cause significant delays, materially disrupt the conduct of our business or adversely affect our revenue, financial condition and results of operations.

As of December 31, 2016, we had a patent portfolio consisting of twenty two issued U.S. patents and two pending patent applications. While we plan to protect our intellectual property with, among other things, patent protection, there can be no assurance that:

·current or future U.S. or foreign patents applications will be approved;

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our issued patents will protect our intellectual property and not be held invalid or unenforceable if challenged by third-parties;

we will succeed in protecting our technology adequately in all key jurisdictions in which we or our competitors operate;

the patents of others will not have an adverse effect on our ability to do business; or

others will not independently develop similar or competing products or methods or design around any patents that may be issued to us.

The failure to obtain patents, inability to obtain patents with claims of a scope necessary to cover our technology or the invalidation of our patents may weaken our competitive position and may adversely affect our revenues.

We may be subject to claims of intellectual property infringement by third parties that, regardless of merit, could result in litigation and our business, operating results or financial condition could be materially adversely affected.

There can be no assurance that we will not receive communications from third parties asserting that our products, and other intellectual property infringe, or may infringe their proprietary rights. We are not currently subject to any proceedings for infringement of patents or other intellectual property rights and are not aware of any parties that intend to pursue such claims against us. Any such claim, regardless of merit, could result in litigation, which could result in substantial expenses, divert the attention of management, cause significant delays and materially disrupt the conduct of our business. As a consequence of such claims, we could be required to pay substantial damage awards, develop non-infringing technology, enter into royalty-bearing licensing agreements, stop selling our products or re-brand our products. If it appears necessary, we may seek to license intellectual property that we are alleged to infringe. Such licensing agreements may not be available on terms acceptable to us or at all. Litigation is inherently uncertain and any adverse decision could result in a loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from others and otherwise negatively affect our business. In the event of a successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed or similar technology, our business, operating results or financial condition could be materially adversely affected.

We use certain “open source” software tools that may be subject to intellectual property infringement claims, the assertion of which could impair our product development plans, interfere with our ability to support our clients or require us to pay licensing fees.

Certain of our products contain open source code, and we may use more open source code in the future. Open source code is code that is covered by a license agreement that permits the user to liberally copy, modify and distribute the software without cost, provided that users and modifiers abide by certain licensing requirements. The original developers of the open source code provide no warranties on such code. As a result of our use of open source software, we could be subject to suits by parties claiming ownership of what we believe to be open source code, and we may incur expenses in defending claims that we did not abide by the open source code license. If we are not successful in defending against such claims, we may be subject to monetary damages or be required to remove the open source code from our products. Such events could disrupt our operations and the sales of our products, which would negatively impact our revenues and cash flow. In addition, under certain conditions, the use of open source code to create derivative code may obligate us to make the resulting derivative code available to others at no cost. If we are required to publicly disclose the source code for such derivative products or to license our derivative products that use an open source license, our previously proprietary software products would be available to others, including our customers and competitors without charge. We monitor our use of such open source code to avoid subjecting our products to conditions that we do not intend. The use of such open source code, however, may ultimately subject some of our products to unintended conditions so that we are required to take remedial action that may divert resources away from our development efforts.



Unfavorable or unstable economic conditions in the markets in which we operate could have a material adverse effect on our business, financial condition or operating results.

In recent years, economies worldwide have demonstrated instability. Negative economic conditions in the global economy or certain regions such as the European Market, from which we derived 38% of our revenues in 2016, could cause a decrease in spending on the types of products and services that we offer.

Additionally, if the worldwide economy remains unstable or further deteriorates, enterprises, telecommunication carriers and service providers in affected regions may significantly reduce or postpone capital investments, which could result in reductions in sales of our products or services, longer sales cycles, slower adoption of new technologies and increased price competition in such regions. Such circumstances would have a material adverse effect on our results of operations and cash flows.

Further, because a substantial portion of our operating expenses consists of salaries, we may not be able to reduce our operating expenses in line with any reduction in revenues and, therefore, may not be able to continue to generate increased revenues and manage our costs to maintain profitability.

Our international operations expose us to the risk of fluctuations in currency exchange rates.

Our revenues are generated primarily in U.S. dollars and a major portion of our expenses are denominated in U.S. dollars. As a result, we consider the U.S. dollar to be our functional currency. A significant portion of our revenue is also generated in Euros, or EUR. Other significant portions of our expenses are denominated in Israeli shekel (ILS) and to a lesser extent in Euros and other currencies. Our ILS-denominated expenses consist principally of salaries and related personnel expenses. We anticipate that a material portion of our expenses will continue to be denominated in ILS. In the past years, we have experienced material fluctuation between the ILS and the U.S. dollar and we anticipate that the ILS will continue to fluctuate against the U.S. dollar in the future. In 2016, the ILS appreciated by approximately 1.5% against the U.S. dollar and in 2015 the ILS depreciated by approximately 0.3% against the U.S. dollar. In 2016, the EUR depreciated by approximately 3.3% against the U.S. dollar, and in 2015 the EUR depreciated by approximately 10.5% against the U.S. dollar. If the U.S. dollar weakens against the ILS or other currencies we are exposed to negative impact on our results of operations. We use derivative financial instruments, such as foreign exchange forward contracts, to mitigate the risk of changes in foreign exchange rates on balance sheet accounts and forecast cash flows. We may not purchase derivative instruments adequately to insulate ourselves from foreign currency exchange risks. The volatility in the foreign currency markets may make hedging our foreign currency exposures challenging. In addition, because a portion of our revenue is not earned in U.S. dollars, fluctuations in exchange rates between the U.S. dollar and the currencies in which such revenue is earned may have a material adverse effect on our results of operations and financial condition. If we wish to maintain the U.S. dollar-denominated value of our products when they are sold in a non-U.S. dollar currency devaluation in the non-U.S. dollar currencies relative to the U.S. dollar could cause our customers to decrease orders and adversely affect our revenue, financial condition and results of operations.

Our actual financial results may differ materially from any guidance we may publish from time to time.

We may, from time to time, voluntarily publish guidance regarding our future performance that represents our management's estimates as of the date of relevant release. Any such guidance is based upon a number of assumptions and estimates that, while presented with numerical specificity, is inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. The principal reason that we may release this data is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons. Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. Further, our sales during any given quarter

tend to be unevenly distributed as individual orders tend to close in greater numbers immediately prior to the relevant quarter end and further. Our revenues from individual customers may also fluctuate from time to time based on the timing and the terms under which further orders are received and the duration of the delivery and implementation of such orders. Therefore, if our projected sales do not close before the end of the relevant quarter, our actual results may be inconsistent with our published guidance. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results will vary from the guidance and the variations may be material. Investors should also recognize that the reliability of any forecasted financial data diminishes the farther in the future that the data is forecast. In light of the foregoing, investors are urged to consider any guidance we may publish in context and not to place undue reliance on it.

## Risks Related to Our Ordinary Shares

The share price of our ordinary shares has been and may continue to be volatile.

Our quarterly financial performance is likely to vary in the future, and may not meet our expectations or the expectations of analysts or investors, which may lead to additional volatility in our share price. The market price of our ordinary shares may be volatile and could fluctuate substantially due to many factors, including, but not limited to:

- announcements or introductions of technological innovations, new products, product enhancements or pricing policies by us or our competitors;
- winning or losing contracts with service providers;
- disputes or other developments with respect to our or our competitors' intellectual property rights;
- announcements of strategic partnerships, joint ventures or other agreements by us or our competitors;
- recruitment or departure of key personnel;
- regulatory developments in the markets in which we sell our products;
- our future repurchases, if any, of our ordinary shares pursuant to our current share repurchase program and/or any other share repurchase program which may be approved in the future;
- our sale of ordinary shares or other securities;
- changes in the estimation of the future size and growth of our markets; or
- market conditions in our industry, the industries of our customers and the economy as a whole.

Share price fluctuations may be exaggerated if the trading volume of our ordinary shares is too low. The lack of a trading market may result in the loss of research coverage by securities analysts. Moreover, we can provide no assurance that any securities analysts will initiate or maintain research coverage of our company and our ordinary shares. If our future quarterly operating results are below the expectations of securities analysts or investors, the price of our ordinary shares would likely decline. Securities class action litigation has often been brought against companies following periods of volatility.

Our shareholders do not have the same protections afforded to shareholders of a U.S. company because we have elected to use certain exemptions available to foreign private issuers from certain NASDAQ corporate governance requirements.

As a foreign private issuer, we are permitted under NASDAQ Rule 5615(a)(3) to follow Israeli corporate governance practices instead of the NASDAQ Stock Market requirements that apply to U.S. companies. As a condition to following Israeli corporate governance practices, we must disclose which requirements we are not following and describe the equivalent Israeli law requirement. We must also provide NASDAQ with a letter from our Israeli outside counsel, certifying that our corporate governance practices are not prohibited by Israeli law. As a result of these exemptions, our shareholders do not have the same protections as are afforded to shareholders of a U.S. company. We currently follow Israeli home country practices with regard to the quorum requirement for shareholder meetings and shareholder approval of equity compensation plans requirements. As permitted under the Israeli Companies Law, 5759-1999, or the Companies Law, our articles of association provide that the quorum for any meeting of shareholders shall be the presence of at least two shareholders present in person or by proxy who hold at least 25% of the voting power of our shares instead of 33 1/3% of our issued share capital (as prescribed by NASDAQ's rules). We submitted a letter from our outside counsel in connection with this item prior to our initial public offering in November 2006. We do not seek shareholder approval for equity compensation plans in accordance with the requirements of the Companies Law, which does not fully reflect the requirements of Rule 5635(c). We submitted a letter from our outside counsel in connection with this item in June 2008.

In the future, we may also choose to follow Israeli corporate governance practices instead of NASDAQ requirements with regard to, among other things, the composition of our board of directors, compensation of officers, director nomination procedures and quorum requirements at shareholders' meetings. In addition, we may choose to follow Israeli corporate governance practice instead of NASDAQ requirements to obtain shareholder approval for certain dilutive events (such as for issuances that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ corporate governance rules. Following our home country governance practices, as opposed to the requirements that would otherwise apply to a U.S. company listed on the Nasdaq Global Select Market, may provide less protection than is accorded to investors of domestic issuers. See "ITEM 16G: Corporate Governance".

As a foreign private issuer, we are not subject to the provisions of Regulation FD or U.S. proxy rules and are exempt from filing certain Exchange Act reports.

As a foreign private issuer, we are exempt from the rules and regulations under the Exchange Act related to 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 Exchange Act. In addition, we are not required under the Exchange Act to file annual and current reports and financial statements with the SEC as frequently or as promptly as U.S. domestic companies whose securities are registered under the Exchange Act, we are permitted to disclose limited compensation information for our executive officers on an individual basis and we are generally exempt from filing quarterly reports with the SEC under the Exchange Act. Moreover, we are not required to comply with Regulation FD, which restricts the selective disclosure of material nonpublic information to, among others, broker-dealers and holders of a company's securities under circumstances in which it is reasonably foreseeable that the holder will trade in the company's securities on the basis of the information. These exemptions and leniencies reduce the frequency and scope of information and protections to which you may otherwise have been eligible in relation to a U.S. domestic issuer.

We would lose our foreign private issuer status if (a) a majority of our outstanding voting securities were either directly or indirectly owned of record by residents of the United States and (b)(i) a majority of our executive officers or directors were United States citizens or residents, (ii) more than 50 percent of our assets were located in the United States or (iii) our business were administered principally in the United States. Our loss of foreign private issuer status



would make U.S. regulatory provisions mandatory. The regulatory and compliance costs to us under U.S. securities laws as a U.S. domestic issuer may be significantly higher. If we are not a foreign private issuer, we will be required to file periodic reports and registration statements on U.S. domestic issuer forms with the SEC, which are more detailed and extensive than the forms available to a foreign private issuer. We would also be required to follow U.S. proxy disclosure requirements, including the requirement to disclose, under U.S. law, more detailed information about the compensation of our senior executive officers on an individual basis. We may also be required to modify certain of our policies to comply with accepted governance practices associated with U.S. domestic issuers. Such conversion and modifications will involve additional costs. In addition, we would lose our ability to rely upon exemptions from certain corporate governance requirements on U.S. stock exchanges that are available to foreign private issuers.

Our U.S. shareholders may suffer adverse tax consequences if we are characterized as a passive foreign investment company.

Generally, if for any taxable year 75% or more of our gross income is passive income, or the average percentage of our assets which produce passive income or which are held for the production of passive income (“passive assets”) is at least 50% of our total net assets, we would be characterized as a passive foreign investment company (“PFIC”) for U.S. federal income tax purposes for such taxable year. Publicly traded corporations must determine the percentage of assets on the basis of the value of their assets. No definitive guidance has been issued by the U.S. government concerning how to value the assets of a foreign public company for PFIC testing purposes. It can be inferred from the legislative history that the fair market value of the total assets of a publicly traded foreign corporation can be more easily measured, and is therefore likely to be less burdensome to taxpayers, by applying the “market capitalization” method. Under the market capitalization method, the total asset value of a company would be considered to equal the aggregate fair market value of its outstanding stock (i.e., its market capitalization) plus its outstanding liabilities, as of a relevant testing date. However, the legislative history did not specify the circumstances under which it would be appropriate to use the “market capitalization” method, or that such method was an exclusive means for valuing the total assets of a publicly traded corporation. Accordingly, if the market capitalization approach is found to be insufficient in the context of the facts and circumstances of a particular case, other reasonable valuation methods may be employed to determine the fair market value of a corporation’s assets. In certain circumstances, including extremely volatile market conditions, it may be appropriate to apply alternative valuation methods, to more accurately determine the fair market value of our assets, such as a valuation of the assets by an independent qualified expert. Given the volatility of the capital markets in recent years, we have obtained an independent valuation of our company for the 2016 tax year, as well as an opinion from a U.S. tax advisor that, applying the results of the independent valuation of our company which employed an approach other than the market capitalization approach, and which provided the reasoning underlying the use of such approach, we should not be a PFIC for the 2016 taxable year. We considered such valuation in determining the value of our total assets and we also considered the above-referenced opinion. On that basis, we believe that we were not a PFIC for the 2016 tax year; however there can be no certainty that the IRS will not challenge such a position and determine that based on the IRS’s interpretation of the asset test, we were a PFIC for the 2016 tax year. Thus, there can be no assurance that we will not be considered a PFIC for 2016 or for any other taxable year. U.S. Holders should consult their own tax advisors concerning the implication of the PFIC rules in his, her or its particular circumstances. See “ITEM 10: Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations.”

If we were characterized as a passive foreign investment company, a U.S. Holder (as defined under “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations”) could avoid certain adverse passive foreign investment company consequences by making a qualified electing fund election to be taxed currently on its proportionate share of the passive foreign investment company’s ordinary income and net capital gains. However, we do not intend to comply with the necessary accounting and record keeping requirements that would allow a U.S. Holder to make a qualified electing fund election with respect to the Company. See “ITEM 10: Additional Information—Taxation—United States Federal Income Taxation—Passive Foreign Investment Company Considerations.”

If the price of our ordinary shares declines, we may be more vulnerable to an unsolicited or hostile acquisition bid.

We do not have a controlling shareholder. Notwithstanding provisions of our articles of association and Israeli law, a decline in the price of our ordinary shares may result in us becoming subject to an unsolicited or hostile acquisition bid. In the event that such a bid is publicly disclosed, it may result in increased speculation regarding our company and volatility in our share price even if our board of directors decides not to pursue a transaction. If our board of directors does pursue a transaction, there can be no assurance that it will be consummated successfully or that the price paid will represent a premium above the original price paid for our shares by all of our shareholders.



Disruption to our IT systems could adversely affect our reputation and have a material adverse effect on our business and results of operations.

Our business operations, production facilities and research and development technologies rely on our IT systems to collect, analyze and store our data. There can be no guarantee that our back-up storages will be effective if it becomes necessary to rely on them. If our existing or future IT systems do not function properly, or if the IT systems prove incompatible with new technologies, we could experience interruptions in data transmissions and slow response times, preventing us from completing routine business, production or research activities.

Additionally, our IT systems contain personal, financial and other information that is entrusted to us by our customers and employees as well as financial, proprietary and other confidential information related to our business. Despite our investments in risk prevention and contingencies, data protection, prevention of intrusions, data leaks and access control systems, we can provide no assurance that our current IT systems are fully protected against third-party intrusions, viruses, hacker attacks, information or data theft or other similar threats. Any such security breach, whether actual or alleged, could result in system disruptions or shutdowns and/or destruction, alteration, theft or unauthorized disclosure of confidential information. The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, including by computer hackers, foreign governments and cyber terrorists, has risen as the number, intensity and sophistication of attempted attacks and intrusions from around the world has increased. Furthermore, there has been heightened legislative and regulatory focus on data security in the U.S. and abroad, including requirements for varying levels of customer notification in the event of a data breach. As we continue to develop our technologies, we may need to update our IT systems and storage capabilities. Any such breach of our information security can result in adverse publicity, a loss of customer confidence, reduced sales and profits, and criminal penalties or civil liabilities, any of which could materially adversely affect our business, operating results and financial condition.

Lastly, disruption or failure of our IT systems for technical reasons, due to natural disasters or other unanticipated catastrophic events, including power interruptions, storms, fires, floods, earthquakes, acts of war or terrorism, could significantly impair our ability to deliver our products on schedule and materially and adversely affect our relationships with our partners and customers, our business, our reputation and our results of operations.

#### Risks Relating to our Location in Israel

Conditions in Israel could adversely affect our business.

We are incorporated under Israeli law and our principal offices, research and development division and manufacturing facilities are located in Israel. Accordingly, political, economic and military conditions in Israel directly affect our business. Since the State of Israel was established in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity, which began in September 2000 and continued with varying levels of severity into 2016. In recent years, these have included, among others, hostilities between Israel and Hezbollah in Lebanon and Hamas in the Gaza strip, both of which resulted in rockets being fired into Israel, causing casualties and significant disruption of economic activities. Any armed conflicts, terrorist activities or political instability in the region may affect a significant portion of our work force, which is located in Israel, and may limit materially our ability to obtain raw materials from these countries or sell our products to companies in these countries. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners, or significant downturn in the economic or financial condition of Israel, could adversely affect our operations and product development and manufacturing, cause our revenues to decrease and adversely affect the share price of publicly traded companies having operations in Israel, such as us.

Our operations may be disrupted by the obligations of personnel to perform military service.

As of December 31, 2016, we employed 440 people, of whom 254 were based in Israel. Some of our employees in Israel are obligated to perform annual military reserve duty in the Israel Defense Forces, depending on their age and position in the army. Additionally, they may be called to active reserve duty at any time under emergency circumstances for extended periods of time. Our operations could be disrupted by the absence of one or more of our executive officers or key employees for a significant period due to military service and any significant disruption in our operations could harm our business. The full impact on our workforce or business if some of our executive officers and employees are called upon to perform military service, especially in times of national emergency, is difficult to predict. Additionally, the absence of a significant number of employees at our manufacturing subcontractor, Flex, as a result of military service obligations may disrupt their operations and could have a material adverse effect on our ability to timely deliver products to customers may be materially adversely affected.

The tax benefits that are available to us require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs and taxes.

Our investment program in equipment at our facility in Hod-Hasharon, Israel, has been granted approved enterprise status and we are therefore eligible for tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959, referred to as the Investments Law. We also have been granted benefited enterprise status. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2016, our net operating loss carry forwards for Israeli tax purposes amounted to approximately \$46.6 million. To remain eligible for these tax benefits, we must continue to meet certain conditions stipulated in the Investments Law and its regulations and the criteria set forth in the specific certificate of approval. If we do not meet these requirements, the tax benefits would be canceled and we could be required to refund any tax benefits and investment grants that we received in the past. Further, in the future these tax benefits may be reduced or discontinued. If these tax benefits are cancelled, our Israeli taxable income would be subject to regular Israeli corporate tax rates. The standard corporate tax rate in Israel for 2017 is 24% and for 2018 and thereafter will be 23% and was 25.0% and 26.5% in 2016 and 2015, respectively.

Effective January 1, 2011, the Investment Law was amended. Under the amended Investment Law, the criteria for receiving tax benefits were revised. Under the transition provisions of the new legislation, a company may decide to irrevocably implement the new amendment while waiving benefits provided under the current law or to remain subject to the current law. In the future, we may not be eligible to receive additional tax benefits under this law. The termination or reduction of these tax benefits would increase our tax liability, which would reduce our profits. Finally, in the event of a distribution of a dividend from the abovementioned tax-exempt income, in addition to withholding tax at the following rates: (i) Israeli resident corporation – 0%, (ii) Israeli resident individual – 20% in 2014 and onwards, and (iii) non-Israeli resident – 20% in 2014 and onwards subject to a reduced tax rate under the provisions of an applicable double tax treaty, would be subject to income tax on the amount distributed in accordance with the effective corporate tax rate which would have been applied had we not enjoyed the exemption. See “ITEM 10: Additional Information—Taxation—Israeli Tax Considerations and Government Programs.”

No assurance can be given that we will be eligible to receive additional tax benefits under the Investments Law in the future. The termination or reduction of these tax benefits would increase our tax liability in the future, which would reduce our profits or increase our losses. Additionally, if we increase our activities outside of Israel, for example, by future acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefit programs.

The government grants we have received for research and development expenditures require us to satisfy specified conditions and restrict our ability to manufacture products and transfer technologies outside of Israel. If we fail to comply with these conditions or such restrictions, we may be required to refund grants previously received together with interest and penalties and may be subject to criminal charges.

We have received grants from the Israel Innovation Authority (formerly known as the Office of the Chief Scientist of the Ministry of Economy) for the financing of a portion of our research and development expenditures in Israel, pursuant to the provisions of The Encouragement of Industrial Research and Development Law, 1984, referred to as the Research and Development Law. In the future we may not receive grants or we may receive significantly smaller grants from the Israel Innovation Authority, and our failure to receive grants in the future could adversely affect our profitability.

In 2014, 2015 and 2016 we received and accrued non-royalty-bearing grants totaling \$1.0 million, \$1.3 million and \$0.6 million, respectively, from the Israel Innovation Authority, representing 3.3%, 4.5% and 2.4%, respectively, of our gross research and development expenditures. In 2014 and 2015 we qualified to participate in two non-royalty-bearing research and development programs, and in one such program in 2016, funded by the Israel Innovation Authority to develop generic technology relevant to the development of our products. Such programs are approved pursuant to special provisions of the Research and Development Law. We were eligible to receive grants

constituting between 40% and 55% of certain research and development expenses relating to these programs. Although the grants under these programs are not required to be repaid by way of royalties, the restrictions of the Research and Development Law described below apply to these programs.

The provisions of the Research and Development Law and the terms of the Israel Innovation Authority grants prohibit us from transferring manufacturing products which we originally planned to manufacture in Israel outside of Israel if they incorporate technologies funded by the Israel Innovation Authority, and from transferring intellectual property rights in technologies developed using these grants, without special approvals from the Israel Innovation Authority.

Even if we receive approval to manufacture our products outside of Israel, we may be required to pay an increased total amount of royalties, which may be up to 300% of the grant amount plus interest, depending on the manufacturing volume that is performed outside of Israel. This restriction may impair our ability to outsource manufacturing or engage in similar arrangements for those products or technologies. Know-how developed under an approved research and development program may not be transferred to any third-parties, except in certain circumstances and subject to prior approval. Similarly, even if we receive approval to transfer intellectual property rights in technologies developed using these grants, we may be required to repay a multiple of the original grants to the Israel Innovation Authority. In addition, if we fail to comply with any of the conditions and restrictions imposed by the Research and Development Law or by the specific terms under which we received the grants, we may be required to refund any grants previously received together with interest and penalties, and may be subject to criminal charges.

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

We are incorporated in Israel. The majority of our executive officers and directors are not residents of the United States, and the majority of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for an investor, or any other person or entity, to enforce a U.S. court judgment based upon the civil liability provisions of the U.S. federal securities laws against us or any of these persons in a U.S. or Israeli court, or to effect service of process upon these persons in the United States. Additionally, it may be difficult for an investor, or any other person or entity, to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws on the grounds that Israel is not the most appropriate forum in which to bring such a claim. Even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing the matters described above.

Provisions of Israeli law and our articles of association may delay, prevent or make undesirable an acquisition of all or a significant portion of our shares or assets.

Our articles of association contain certain provisions that may delay or prevent a change of control, including a classified board of directors. In addition, Israeli corporate law regulates acquisitions of shares through tender offers and mergers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law could delay or prevent a change in control and may make it more difficult for third-parties to acquire us, even if doing so would be beneficial to our shareholders, and may limit the price that investors may be willing to pay for our ordinary shares in the future. Furthermore, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders. See “ITEM 10: Additional Information—Memorandum and Articles of Association—Acquisitions under Israeli Law” and “—Anti-Takeover Measures.”



## ITEM 4: Information on Allot

### A. History and Development of Allot

#### Our History

Our legal and commercial name is Allot Communications Ltd. We are a company limited by shares organized under the laws of the State of Israel. Our principal executive offices are located at 22 Hanagar Street, Neve Ne'eman Industrial Zone B, Hod-Hasharon 4501317, Israel, and our telephone number is +972 (9) 761-9200. We have irrevocably appointed Allot Communications Inc. as our agent to receive service of process in any action against us in any United States federal or state court. The address of Allot Communications Inc. is 300 TradeCenter, Suite 4680, Woburn, MA 01801-7422.

We were incorporated on November 12, 1996 as “Ariadne Ltd.” and commenced operations in 1997. In September 1997, we changed our name to “Allot Communications Ltd.”. In November 2006, we listed our shares on NASDAQ. In 2007, we introduced our Service Gateway platform that enables broadband providers to build efficient, secure, manageable and profitable intelligent networks that are optimized to deliver Internet-based content and services. In 2008, we completed the acquisition of the business of Eshion Limited, a developer of network protection solutions for carriers and internet service providers. In 2010, we listed our shares on the Tel Aviv Stock Exchange, or TASE, and began applying the reporting reliefs afforded under the Israeli Securities Law to companies whose securities are dually listed on NASDAQ and the TASE. In 2012, we acquired the business of Ortiva Wireless Inc., a developer of video optimization solutions for mobile and Internet networks. In 2012, we acquired the business of Oversi Networks Ltd., a developer of products and systems for caching Internet content. In 2015, we acquired substantially all of the assets and business of Optenet S.A., a Madrid-based global IT security company.

### B. Business Overview

#### Overview

We are a leading global provider of visibility, intelligence, security and monetization solutions that enable service providers and enterprises to protect and personalize the digital experience. Allot's flexible and highly scalable service delivery framework leverages the intelligence in data networks, enabling service providers to get closer to their customers, safeguard network assets and users, and accelerate time-to-revenue for value-added services.

We have a global and diverse customer base composed of mobile and fixed broadband service providers, cable operators, private networks, data centers, governments and enterprises, such as financial and educational institutions. Our scalable, carrier-grade solutions integrate capabilities that allow our customers to optimize the delivery and performance of over-the-top (OTT) applications and services, monetize network utilization through value-added product deployment, security service offerings, real-time metering and application-aware charging models and personalize the user experience through service tiering and differentiation.

Through our combination of innovative technology, proven know-how and collaborative approach to industry standards and partnerships with broadband service providers and enterprises, we deliver broadband solutions that equip our customers with the capabilities to elevate their role in the digital lifestyle ecosystem and to expand into new business opportunities. We offer our customers proprietary technologies that are seamlessly woven into carrier-class products and solutions. In addition, we have developed significant industry know-how and expertise through our experience in designing and implementing use cases with our diverse customer base. Beginning from the proposal stage of a new project through the testing, acceptance and implementation of our products, we collaborate closely with our customers and other industry participants to create innovative solutions to create the digital lifestyle ecosystems that our customers require.



## Industry Background

The rapid proliferation of broadband networks in recent years has been largely driven by demand from users for faster and more reliable access to the Internet and by the proliferation in the number and complexity of broadband applications, as well as the proliferation of mobile smartphones, tablets and other Internet-connected devices.

### Rising Network Operational Costs Due to the Rapid Adoption of Broadband Applications

Advances in broadband access (such as the introduction of long-term evolution, or LTE, technology) combined with the advanced data capabilities of end-user devices (such as smartphones and tablets) have promoted a growing number of applications and content delivered over broadband networks. The vast majority of these applications run over-the-top of the network, which means they are not originated, controlled or charged by the network operator. The use of OTT applications, such as streaming video, peer-to-peer (P2P), Voice over IP (VoIP), social networks, interactive gaming and online content, requires large and increasing amounts of bandwidth. Moreover, many of these applications are highly sensitive to network delays caused by congestion. In response to these challenges, service providers have been forced to invest heavily in network infrastructure upgrades and customer support services in order to maintain the quality of experience for subscribers.

### Rising Data Traffic in Mobile Networks

The mobile data market continues to grow rapidly, fueled by the proliferation of smartphones and tablets, mobile-enabled laptops that use mobile modems or tethered smartphones to connect to the Internet. On average, the data traffic generated by an Internet user with a smartphone is multiple times that of an Internet user without a smartphone.

The cost of increasing the bandwidth in mobile networks is significantly higher than that in wireline networks. As a result, mobile operators are experiencing economic and infrastructure challenges in meeting the rising tide of data traffic over their networks. In addition, as capacity increases in mobile networks, smartphone users are likely to have increased expectations with respect to speed and performance.

It is becoming increasingly apparent that unmanaged 3G and 4G/LTE mobile networks will not be able to cope with the rising tide of data traffic, without implementing intelligent bandwidth management solutions. Moreover, network providers may need to develop new pricing models if they are not able to monetize the OTT traffic carried by their networks.

### Service Providers Demand the Ability to Offer Services that Can Be Monetized at Different Rates

Some service providers still offer flat-rate broadband access, regardless of the type of applications and data used by subscribers. These operators provide the same level of service to all subscribers and do not guarantee access quality, regardless of a subscriber's willingness to pay for premium services and network performance. However, with the increasing amount of data used, the flat-rate pricing model may not be profitable, especially for mobile broadband operators, unless they can charge subscribers high rates. As a result, both mobile and fixed operators have begun to offer service plans based on gigabytes of data used. However, this pricing model is also subject to competition from other service providers offering lower rates, contributing to downward pricing pressure and high subscriber turnover rates.

To address these issues and increase the average revenue per user (ARPU), a significantly increased number of service providers have begun to offer premium, differentiated services, such as free usage for specific applications, content bundling, off-peak usage incentives, security services, improved quality for VoIP and Internet video, among others. By offering such tiered services and charging subscribers according to the value of these services, as well as based on the gigabyte usage, service providers can capitalize on the revenue opportunities embodied in their networks. To offer

premium services and to guarantee high-quality delivery of content and user experience, service providers need enhanced visibility into and control of network traffic, including visibility into the type of applications used on the network and levels of traffic generated by different subscribers.

## The Challenge of Elevating the Role of Fixed and Mobile Broadband Networks

In the evolving digital lifestyle, consumers recognize the importance of the devices they use to access the Internet and choose the Internet content and services they use based on quality. However, the network that connects them to the Internet is not as “visible”, and is therefore not as highly valued, even though it plays a critical role in the service chain. In order to generate revenue through various pricing models and encourage consumers and content providers to seek higher quality network services, service providers are seeking to elevate the role of network connectivity and services. To do so, service providers must be able to identify and leverage the business intelligence in their data networks and capitalize on the network traffic that they generate.

The ability to identify, distinguish and prioritize different applications plays a major role in intelligent management of network resources and service delivery, allowing service providers to optimize bandwidth utilization and reduce operational costs, while maintaining high quality of service for tiered and premium services. Application designers are employing increasingly sophisticated methods to avoid detection by network operators who desire to manage network use. Traditional network infrastructure devices, such as routers and switches, do not generally have sufficient computing resources or the required algorithms to distinguish between different and rapidly evolving applications.

### Network Security Threats

As reliance on the Internet has grown, service provider and enterprise networks have become increasingly vulnerable to a wide range of security threats, including distributed denial of service attacks, spambots malware and other threats. These attacks are designed to flood the network with traffic that consumes all the available bandwidth and hinder the ability to provide high quality broadband access to subscribers or to prevent enterprises from using mission-critical applications. These threats also compromise network and data integrity. We believe service providers and enterprises must protect against such attacks by detecting and neutralizing malicious traffic at very early stages before such threats can compromise network integrity and services.

### End-User Security Threats

Broadband devices, especially mobile devices, are increasingly vulnerable to online threats such as malware and phishing. Since most broadband users have limited cyber-security expertise, they become easy targets for cybercriminals. Mobile device users are even more exposed since the threat awareness is lower than that of PC users. There are several options to safeguard broadband users on-the-go. We believe service providers must protect their subscribers by providing security-as-a-service so that individual and business customers are always protected seamlessly from the network security threats.

### Enterprise Demand for Visibility and Delivery of Mission-Critical Applications and Services in the Cloud

The proliferation of network applications, bring your own device and cloud computing present significant challenges for enterprises that operate data centers, wide-area networks, virtual private networks (VPN) and Internet connectivity for organizations of all sizes. Enterprises depend on network infrastructure to ensure the delivery of business-critical applications to an increasingly mobile and often global workforce, and as such, face many of the same issues as service providers. At the same time, Internet access has introduced a wide variety of recreational and non-business applications to enterprise networks, resulting in network congestion and negatively impacting employee productivity. As a result, there is an increasing need for enterprises to be able to monitor and control the traffic on their business networks.

### Integrated Solutions

Our integrated broadband solutions allow mobile, fixed and enterprise operators to elevate their role in the digital lifestyle ecosystem and expand into new business opportunities. Our solutions enable our customers to increase

revenues by monetizing network usage through value-added products and services, value-based charging, reduce costs by optimizing the delivery and performance of OTT content and cloud computing services and improve customer loyalty by personalizing operator offerings with various choices of service tiers and digital lifestyle options.

Our Integrated Solutions include:

Analytics solutions deliver accurate and meaningful network business intelligence to drive capacity planning, congestion management, service planning and marketing decisions.

Traffic Management solutions prioritize existing network capacity, control congestion and optimize service delivery. Dynamic Quality of Service (QoS) enforcement enables effective traffic management strategies that minimize infrastructure and operating costs.

Policy Control and Charging solutions drive personalized service plans and pay-for-use pricing models based on real-time consumption of bandwidth and OTT applications. We provide a single point of integration with provisioning and pricing systems.

Service Enablement solutions facilitate a wide variety of cost-saving and revenue-generating use cases to create personalized customer experiences demanded by today's sophisticated consumers.

"Security as a Service" Solutions enable operators to secure the digital experience against online threats and harmful content, by providing network based Security as a Service (SECaaS) to their end customers.

Network Core Security Solutions, focused on identifying and blocking large scale Distributed Denial of Service (DDoS) attacks on the core network elements of service providers.

Allot's Products (Our Platforms)

The Allot Service Gateway platforms (including Allot Service Gateway Tera, and Allot Service Gateway 9500) as well as Allot NetEnforcer platforms are based on leading technology and high performance, designed for in-line deployment in a wide range of networks. Allot service Gateway platforms are designed for deployment both on traditional and virtualized network access infrastructure. Within each platform, our Dynamic Actionable Recognition Technology (DART) engine employs multiple deep packet inspection (DPI) and analytical methods to identify network traffic by subscriber, application, device and network topology. Our technology is able to identify more OTT applications than any other solution on the market with frequent and custom updates to our extensive signature library. These granular elements may be mapped directly into dynamic traffic management, charging and service enablement policies.

High-Performance Platforms

Allot Service Gateway 9500 provides visibility, control and security of application and user traffic in cloud data centers and ISP networks. The platform provides a unified framework and single point of integration for traffic visibility and policy enforcement, charging, as well as pre-integrated services, including, web and cyber security, and web optimization, cyber threat protection, data sourcing, and network analytics.

Allot Service Gateway Tera powers the deployment and delivery of digital lifestyle services in fixed, mobile and cloud networks that are on the path to software-defined networking (SDN) and virtualized network services (NFV). The Allot Service Gateway Tera provides a unified framework for traffic detection, policy enforcement and service integration across any access network, and helps manage traffic loads, keeping pace with the growing demand for services and the complex needs of application delivery. Allot Service Gateway Tera supports both physical and virtual service deployment and serves as a single point of seamless integration in the network for real-time data sourcing, traffic management, service chaining, application-based charging, endpoint protection and anti-DDoS, as well as value-added services from other leading vendors.





Allot Service Gateway Virtual Edition provides contemporary, software only based version of our Service Gateway functionality, enabling telecommunication service providers to deploy leading integrated network intelligence, policy enforcement and revenue-generating services in a scalable manner, which complies with any hardware and orchestration infrastructure used by the provider. Our Service Gateway Virtual Edition enables both on-premises and cloud deployments, and provides the promise of expansion on demand based on the actual traffic dynamic of the network.

Allot Secure Service Gateway integrates network intelligence, policy enforcement, and web security in a single scalable platform for large enterprises. This unified platform offers enterprises a cost-effective solution of advance technologies for visibility, control and security of their network. Allot's SSG ranges from several hundred Mbps (megabits per second ) to several dozen Gbps, hence providing full coverage to even the most complex enterprise network.

Allot NetEnforcer bandwidth management devices monitor and manage network traffic per application and per subscriber, enabling intelligent optimization of broadband and wide area network (WAN) services. With full duplex speeds ranging from 10 megabits per second (Mbps) to 16 Gbps, these devices provide essential visibility policy enforcement and traffic steering to added-value services in a wide range of service provider and enterprise networks.

### Subscriber Management Platform

The Allot Subscriber Management Platform (SMP) drives the centralized creation, provisioning and pricing of subscriber services, including tiered and usage-based data plans, which we believe are key to personalizing digital lifestyle offerings and maximizing average revenue per user. The Allot SMP allows subscriber traffic to be managed across converged access networks and when offloading to Wi-Fi hotspots. Modular licensing provides flexible and scalable management for any number of subscribers.

**Allot TierManager:** Provides and manages differentiated services and tiered service plans that are tailored to subscriber preferences.

**Allot QuotaManager:** Provides and manages usage allowances and caps, with real-time metering of service consumption and dynamic enforcement of quota limits and overage policy.

**Allot ChargeSmart:** Enables real-time, pay-for-use pricing, based on a user's consumption of data and applications. It also integrates seamlessly in 3G and 4G mobile networks and implements the pricing model via standard telecommunication interfaces, such as Diameter Gx, Sd, Gy and Gz.

**Allot Smart Engage Onboarding:** Allows operators to engage customers at first time broadband usage, and also increase on going engagement, including, increasing introduction of services and number of opt-ins for add-on services.

### Analytics Services

Our analytics solutions analyze traffic data to drive smart business decisions.

**Allot ClearSee Analytics:** Is a business intelligence application that helps network operators turn big data into valuable insight for the decision-makers in their organization. Its self-service approach allows network operators to synthesize and analyze large varieties and volumes of data with extreme efficiency. Tools include built-in dashboards for mining Network, Application, Subscriber, Device, and Quality of Experience data, plus Self-Service data mining for modeling fresh perspectives and gaining deeper understanding of network usage and subscriber behavior.

Allot ClearSee Data Source: Extracts a rich variety of raw traffic statistics from operator networks, enriches it with data from operator business systems, and loads it into a cutting-edge data warehouse where it is transformed into modeled data objects that are meaningful to telco operators and easy to manipulate using the Allot ClearSee Analytics application. This valuable source data may also be exported to external analytics tools and other business applications.

## Security Solutions

Our security solutions protect network customers, network service integrity and brand reputation.

**Allot WebSafe Personal:** Opt-in security services that allow ISP subscribers to define and enforce safe-browsing limits (Parental Control) and to prevent incoming malware from infecting their devices (Anti-Malware). Services are enforced at the network level, requiring no device involvement or battery consumption.

**Allot WebSafe:** URL filtering service that blocks blacklisted content and enables access control to objectionable content on the Internet.

**Allot WebSafe Business:** Enables managed security service providers to protect the digital assets of business customers, whose applications are migrating to the cloud and whose employees are increasingly mobile. Allot WebSafe Business provides flexible, multi-tenant Security as a Service to small and medium business (SMB) customers, including, web (URL) filtering, anti-malware, application control and mail security.

**Allot ServiceProtector:** Attack detection and mitigation services that protect commercial networks against Denial of Service (DoS/DDoS) attacks, Zero Day attacks, worms, zombie and spambot behavior.

**Allot Content Protector:** Provides a carrier-class URL filtering service that blocks access to blacklisted and illegal content, enabling network operators to comply with regulatory requirements.

**Allot SpamOut Protector:** Prevents malicious spambots from compromising operators' network service, and includes anti-spam filter which detects and blocks outbound spam and protects network and IP domain against being blacklisted as a spammer or a phishing security risk.

**McAfee Unified Security Powered by Allot:** Provides end-to end security capabilities through combining Allot's multi-tenant network-based security platform and McAfee endpoint protection. Offering On-Net and Off-Net coverage, the solution blends advanced threat detection technologies in network and at the endpoint with customer intelligence and comprehensive personalization capabilities to deliver a scalable platform that simplifies security service activation, service awareness, operation and management.

## Centralized Management

The Allot NetXplorer is the management umbrella for our devices, platforms and solutions, providing a central access point for network-wide monitoring, reporting, analytics, troubleshooting, accounting and QoS policy provisioning. Its user-friendly interface provides our customers with a comprehensive overview of the application, user, device and network topology traffic, while its wide variety of reports provide accessible, detailed analyses of granular traffic data.

**NetXplorer Analytics and Reporting:** Real-time reporting provides 30-second accuracy for timely troubleshooting and resolution of customer care issues, while historical traffic statistics facilitate analyses of usage trends and user behavior.

**NetXplorer Data Collector:** Provides distributed data collection and storage at different points in the network in order to support growing and large-scale deployments with large volumes of network traffic.

**NetAccounting Server:** Aggregates network-wide usage statistics and exports the data to external accounting systems in standard formats.

**NetPolicy Provisioner:** Provides a virtual "bandwidth management device" for self-monitoring and self-provisioning by a networks operator's VPN, ISP and managed services customers.



## Customers

We have a global, diversified customer base consisting primarily of mobile and fixed service providers, cable operators, private networks, data centers, governments and enterprises. We derive a significant and growing portion of our revenue from direct sales to large mobile and fixed-line service providers. We generate the remainder of our revenue through a select and well-developed network of channel partners, generally consisting of distributors, resellers, OEMs and system integrators. In 2016, we derived 38% of our revenues from Europe, 31% from Asia and Oceania, 14% from the Middle East and Africa and 14% from the Americas (excluding the United States) and 3% from the United States. For a breakdown of total revenues by geographic location, see “ITEM 5.A – Operating Results – Results of Operations – Revenues.”

## Channel Partners

We market and sell our products to end-customers both by direct sales and through channel partners, which include distributors, resellers, OEMs and system integrators. A significant portion of our sales occur through our channel partners. In 2016, approximately 41% of our revenues were derived from channel partners. Our channel partners are responsible for installing and providing initial customer support for our products. Our channel partners are located around the world and address most major markets. Our channel partners target a range of end-users, including carriers, alternative carriers, cable operators, private networks, data centers and enterprises in a wide range of industries, including government, financial institutions and education. Our agreements with channel partners that are distributors or resellers are generally non-exclusive, for an initial term of one year and automatically renew for successive one-year terms unless terminated. After the first year, such agreements may typically be terminated by either party upon ninety days prior notice.

We offer support to our channel partners. This support includes the generation of leads through marketing events, seminars and web-based leads and incentive programs as well as technical and sales training.

## Sales and Marketing

Our product sales cycle varies based on the intended use by the end-customer. The sales cycle for initial network deployment may generally last between twelve and eighteen months for large and medium service providers, six to twelve months for small service providers, and one to six months for enterprises. Follow-on orders and additional deployment of our products usually require shorter cycles. Large and medium service providers generally take longer to plan the integration of our solutions into their existing networks and to set goals for the implementation of the technology.

We focus our marketing efforts on product positioning, increasing brand awareness, communicating product advantages and generating qualified leads for our sales organization. We rely on a variety of marketing communications channels, including our website, trade shows, industry research and professional publications, the press and special events to gain wider market exposure.

We have organized our worldwide sales efforts into the following territories: North America, South America, Europe, the Middle East and Africa; and Asia and Oceania. We have regional offices in the United States, Israel, France, United Kingdom, Spain, Colombia, Singapore, Japan, New Zealand, China, Italy and India and a regional presence in Germany, Mexico, Brazil, Hong Kong, South Korea, South Africa and Australia.

As of December 31, 2016, our sales and marketing staff, including product management and business development functions, consisted of 99 employees.

## Service and Technical Support

We believe our technical support and professional services capabilities are a key element of our sales strategy. Our technical staff provides support and professional services, as well as assists in presale activities and advises channel partners on the integration of our solutions into end-customer networks. Our basic warranty to end-customers (directly or through our partners) is three months for software and twelve months for hardware. Generally, end-customers are also offered a choice of one year or multi-year customer support programs when they purchase our products. These customer support programs can be renewed at the end of their terms. Our end-customer support plans generally offer the following features:

- unlimited 24/7 access to our global support organization, via phone, email and online support system, provided by regional support centers;
- expedited replacement units in the event of a warranty claim;
- software updates and upgrades offering new features and protocols and addressing new and changing network applications; and
- periodic updates of solution documentation, technical information and training.

Our support plans are designed to maximize network up-time and minimize operating costs. Our customers, including partners and their end-customers, are entitled to take advantage of our around-the-clock technical support which we provide through our six support centers, located in France, Israel, Singapore, India, Colombia and the United States. We also offer our customers, 24-hour access to an external web-based technical knowledge base, which provides technical support information and, in the case of our channel partners, enables them to support their customers independently and obtain follow up and support from us.

Many of our strategic customers purchase special support contracts, which include specific service levels (for example, with respect to response time, restoration time, resolution time, on-site support, spare parts management, and resident engineers).

We also offer particular professional services, such as, network audit, solution design, project management, business intelligence reports, customer project documentation, integration services, interoperability testing and training and specific customizations.

The expenditures associated with the technical support staff are allocated in our statements of comprehensive loss between sale and marketing expenses and cost of goods sold, based on the roles of and tasks performed by personnel.

As of December 31, 2016, our technical staff consisted of 117 employees, including 52 technical support persons, 51 deployment and professional services engineers, 6 documentation and training persons, and eight business operation and CS management.

## Research and Development

Our research and development activities take place primarily in Israel. We also have research and development activities in Spain and Mexico. As of December 31, 2016, 117 of our employees in Israel, 42 of our employees in Spain and four of our employees in Mexico, were engaged primarily in research and development. We devote a significant amount of our resources towards research and development in order to introduce new products and continuously enhance existing products and to support our growth strategy. We have assembled a core team of experienced engineers, many of whom are leaders in their particular field or discipline and have technical degrees from top universities and have experience working for leading Israeli or international networking companies. These engineers are involved in advancing our core technologies, as well as in applying these core technologies to our product development activities. In previous years, our research and development efforts have benefited from royalty-bearing grants from the Israel Innovation Authority. As of December 31 2016, there are no outstanding royalties due from us to the Israel Innovation Authority. In 2016, we benefited from additional grants from the Israel Innovation Authority, however, these grants do not bear royalties. Under the terms of those grants we are required to perform our manufacturing activities within the state of Israel, as a condition to maintaining these benefits. The State of Israel does not own any proprietary rights in technology developed with the Innovation Authority funding and there is no restriction related to the Israel Innovation Authority on the export of products manufactured using technology developed with the Israel Innovation Authority funding (other limitations on export apply under applicable law). For a description of restrictions on the transfer of the technology and with respect to manufacturing rights, please see “ITEM 3: Key Information—Risk Factors—The government grants we have received for research and development expenditures require us to satisfy specified conditions and restrict our ability to manufacture products and transfer technologies outside of Israel. If we fail to comply with these conditions or such restrictions, we may be required to refund grants previously received together with interest and penalties and may be subject to criminal charges.”

## Manufacturing

We subcontract the manufacture and repair of the hardware components of our Service Gateway platforms and our NetEnforcer traffic management systems to Flex (Israel) Ltd., which manufactures these components in accordance with our design. This strategy enables us to reduce our fixed costs, focus on our core research and development competencies and provide flexibility in meeting market demand. Flex (Israel) is contractually obligated to provide us with manufacturing services based on agreed specifications, including manufacturing, assembling, testing, packaging and procuring the raw materials for our devices. We are not required to provide any minimum orders. Our agreement with Flex (Israel) is automatically renewed annually for additional one-year terms. Flex (Israel) may terminate our agreement with them at any time during the term upon prior notice. We retain the right to procure independently any of the components used in our products. Flex (Israel) has a U.S. affiliate to which it can, with the prior consent of the Israel Innovation Authority, transfer manufacturing of our products if necessary, in which event we may be required to pay increased royalties to the Israel Innovation Authority. We expect that it would take approximately six months to transition manufacturing of our products to an alternate manufacturer.

We subcontract the integration of our security software products with an off-the- shelf hardware platforms provided by Lenovo and Hewlett Packard Enterprise (HP). Based on verbal understandings, Arrow ocs (Israel) performs the integration of the software product with HP servers, while Malam-Team (Israel) performs the integration of such software with Lenovo Servers. Such hardware components are manufactured in accordance with our design.

We design and develop internally a number of the key components for our products, including printed circuit boards. Some of the hardware components of our products are obtained from single or limited sources. Since our products have been designed to incorporate these specific components, any change in these components due to an interruption in supply or our inability to obtain such components on a timely basis may require engineering changes to our products before we could incorporate substitute components. In particular, we purchase the central processing unit for our Service Gateway platforms and for our NetEnforcer products from NetLogic Microsystems, Inc. (now part of Broadcom Corporation, recently acquired by Avago). We also purchase off the shelf hardware components from

single or limited sources for our security and Traffic Management products. We carry approximately three to six months of inventory of key components. We also work closely with our suppliers to monitor the end-of-life of the product cycle for integral components, and believe that in the event that they announce end of life, we will be able to increase our inventory to allow enough time for replacing such components. The agreements with our suppliers do not contain any minimum purchase or supply commitments. Product testing and quality assurance is performed by our contract manufacturer using tests and automated testing equipment and according to controlled test documentation we specify. We also use inspection testing and statistical process controls to assure the quality and reliability of our products.



## Competition

We compete against large companies in a rapidly evolving and highly competitive sector of the networking technology market, which offer, or may offer in the future, competing technologies, including partial or alternative solutions to operators' challenges, and which, similarly to us, intensely pursue the largest service providers (referred to as Tier 1 operators). Our DPI technology enabled offerings face significant competition from router and switch infrastructure companies, that integrate functionalities into their platforms addressing some of the same types of issues that our products are designed to address.

Our security products, which are offered to operators and are deployed in their networks for the purpose of enabling them to provide security services to their end customers, are subject to competition from companies which offer security products, based on different technology and marketing and sales approaches. Generally, we compete on the basis of product performance, ease of use and installation, customer support and price.

Our security product offerings face significant competition from companies that directly approach end customers and offer them security applications to be installed on their devices; companies that approach the business enterprise sector through distribution channels and offer cloud security products; and companies that offer security products bundled with other products. By offering our security products to operators that provide security services to both business enterprises and individual end customers, we aim to expand the reach of our products.

See "ITEM 3: Key Information—Risk Factors— Our revenues and business may be adversely affected if we do not effectively compete in the markets in which we operate."

## Intellectual Property

Our intellectual property rights are very important to our business. We believe that the complexity of our products and the know-how incorporated into them makes it difficult to copy them or replicate their features. We rely on a combination of confidentiality and other protective clauses in our agreements, copyright and trade secrets to protect our know-how. We also restrict access to our servers physically and through closed networks since our product designs and software are stored electronically and thus are highly portable.

We customarily require our employees, customers, distributors, resellers, software testers, technology partners and contractors to execute confidentiality agreements or agree to confidentiality undertakings when their relationship with us begins. Typically, our employment contracts also include assignment of intellectual property rights for all inventions developed by employees, non-disclosure of all confidential information, and non-compete clauses, which generally restrict the employee for six months following termination of employment. The enforceability of non-compete clauses in certain jurisdictions in which we operate may be limited. See "ITEM 3: Key Information—Risk Factors— If we are unable to successfully protect the intellectual property embodied in our technology, our business could be harmed significantly." Because our product designs and software are stored electronically and thus are highly portable, we attempt to reduce the portability of our designs and software by physically protecting our servers through the use of closed networks, which prevent external access to our servers.

The communications equipment industry is characterized by constant product changes resulting from new technological developments, performance improvements and lower hardware costs. We believe that our future growth depends to a large extent on our ability to be an innovator in the development and application of hardware and software technology. As we develop the next generation products, we intend to pursue patent protection for our core technologies in the telecommunications segment. We plan to seek patent protection in our largest markets and our competitors' markets, for example in the United States and Europe. As we continue to move into new markets, such as Japan, Korea and China, and Latin America countries we will evaluate how best to protect our technologies in those markets. We intend to vigorously prosecute and defend the rights of our intellectual property.

As of December 31, 2016, we had twenty two issued U.S. patents and two pending patent applications in the United States. We expect to formalize our evaluation process for determining which inventions to protect by patents or other means. We cannot be certain that patents will be issued as a result of the patent applications we have filed.

We have obtained a U.S. trademark registration for one of our key marks that we use to identify our products or services: "NetEnforcer."

## Government Regulation

See “ITEM 5: Overview—Government Grants” for a description of grants received from the Israel Innovation Authority of the Ministry of Economy.

## C. Organizational Structure

As of December 31, 2016, we held directly and indirectly the percentage indicated of the outstanding capital stock of the following subsidiaries:

Company	Jurisdiction of Incorporation	Percentage Ownership
Allot Communications Inc.	United States	100 %
Allot Communications Europe SARL	France	100 %
Allot Communications (Asia Pacific) Pte. Limited	Singapore	100 %
Allot Communications (UK) Limited (with branches in Spain, Italy and Germany)	United Kingdom	100 %
Allot Communications Japan K.K.	Japan	100 %
Allot Communications (New Zealand) Limited (with a branch in Australia)	New Zealand	100 %
Oversis Networks Ltd.	Israel	100 %
Allot Communications (Hong Kong) Ltd	Hong Kong	100 %
Allot Communications Africa (PTY) Ltd	South Africa	100 %
Allot Communications India Private Ltd	India	100 %
Allot Communications Spain, S.L. Sociedad Unipersonal	Spain	100 %
Allot Communications (Colombia) S.A.S	Colombia	100 %
Allot MexSub	Mexico	100 %

\* Allot Communications Ltd. also holds a branch in Colombia.

## D. Property, Plant and Equipment

Our principal administrative and research and development activities are located in our approximately 68,049 square foot (6,322 square meter) facilities in Hod-Hasharon, Israel. The leases for our facilities vary in dates and terms, with the main facility’s non-stabilized lease expiring in June 2018.

We also lease a 5,888 square foot (547 square meter) facility in Woburn, Massachusetts, for the purposes of our U.S. sales and marketing operations pursuant to a lease that expires in August 2019. We lease a total of 10,872 square foot (1,010 square meter) in three facilities in Spain, mainly for our sales and research and development operations in Spain, pursuant to lease agreements. The lease agreement of our main site in Spain expires on October 2017. We lease other smaller facilities for the purpose of our sales and marketing and support activities in France, the United Kingdom, Italy, Germany, Singapore, China, Japan, South Africa, Colombia, New Zealand and India.

## ITEM 4A: Unresolved Staff Comments

Not applicable.

## ITEM 5: Operating and Financial Review and Prospects

The information contained in this section should be read in conjunction with our consolidated financial statements for the year ended December 31, 2016 and related notes and the information contained elsewhere in this annual report. Our financial statements have been prepared in accordance with US GAAP. This discussion contains forward-looking statements that are subject to known and unknown risks and uncertainties. As a result of many factors, such as those set forth under “ITEM 3.D: Risk Factors” and “Cautionary Note Regarding Forward-Looking Statements,” our actual results may differ materially from those anticipated in these forward-looking statements.

### A. Operating Results

#### Overview

We are a leading global provider of security and monetization solutions that enable service providers and enterprises to protect and personalize the digital experience. Allot’s flexible and highly scalable service delivery framework leverages the intelligence in data networks, enabling service providers to get closer to their customers, safeguard network assets and users, and accelerate time-to-revenue for value-added services. Our customers use our solutions to create sophisticated policies to monitor network applications, enforce quality of service policies that guarantee mission-critical application performance, mitigate security risks and leverage network infrastructure investments. Demand from users for faster and more reliable access to the Internet, an increase in the number and complexity of broadband applications, and growth in mobile data-enhanced smartphones have resulted in the rapid proliferation of broadband access networks in recent years. Our carrier-class products are used by service providers to offer subscriber-based and application-based tiered services that enable them to optimize their service offerings, reduce churn rates and increase ARPU.

We market and sell our products through a variety of channels, including direct sales and through our channel partners, which include distributors, resellers, OEMs and system integrators. End customers of our products include carriers, mobile operators, cable operators, wireless, wireline and satellite Internet service providers, educational institutions, governments and enterprises. The resulting intelligent, content-aware broadband networks enable our customers to accurately monitor and manage IP traffic per application, subscriber, network topology and device.

In 2016, the primary drivers of our revenues were the mobile and fixed markets, which were highlighted by our ongoing relationship with global Tier 1 mobile and fixed operators groups.

In 2012, we acquired the business of Ortiva Wireless Inc. (“Ortiva”), a developer of solutions for mobile and Internet networks and Oversi Networks Ltd. (“Oversi”), a developer of products and systems for caching Internet content.

In March 2015, we acquired the business and substantially all of the assets of Optenet, S.A., a developer of security solutions for internet service providers and enterprises. Under the terms of the agreement, the consideration includes approximately \$9.9 million (€8.9 million) in cash. In addition, there is a performance-based earn-out over a period of five years following closing, which is capped at approximately \$27.5 million (€25 million) and is contingent upon reaching certain revenues threshold from sale of Optenet products. The fair value of the contingent consideration as of the acquisition date was estimated at \$8.1 million (€7.3 million). See Note 1(b) to our consolidated financial statements for further information.

#### Key measures of our performance

##### Revenues

We generate revenues from two sources: (1) sales of our network traffic management systems and our network management application solutions and platforms, and (2) maintenance and support services and professional services,

including installation and training. We generally provide maintenance and support services pursuant to a one- to three-year maintenance and support program, which may be purchased by customers at the time of product purchase or on a renewal basis.

We recognize revenues from product sales when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with respect to implementation remain, the fee is fixed or determinable and collection is probable. We typically grant a one-year hardware and three-month software warranty on all of our products, or one-year hardware and software warranty to customers that purchase annual maintenance and support. Typically our support contracts with our customers, provide hot line support, warranty, software updates and upgrades, if and when available. We record a provision for warranty at the time the product's revenue is recognized. We estimate the liability of possible warranty claims based on our historical experience. Warranty claims have to date been immaterial to our results of operations. Maintenance and support revenues are recognized on a straight-line basis over the term of the applicable maintenance and support agreement. See “—Critical Accounting Policies and Estimates—Revenue Recognition” below.

Customer concentration. We derived 44%, 37% and 42% of our total revenues from two Tier 1 mobile and fixed operators in 2014, 2015 and 2016, respectively.

Geographical breakdown. See “ITEM 4B: Information on Allot—Business Overview—Customers” for the geographic breakdown of our revenues by percentage for the years ended December 31, 2014, 2015 and 2016.

#### Cost of revenues and gross margins

Our products' cost of revenues consists primarily of costs of materials, manufacturing services and overhead, warehousing and product testing. Our services' cost of revenues consists primarily of salaries and related personnel costs for our customer support staff as well as the royalty payments mentioned above. We expect our percentage of gross margin to decrease as a result of additional personnel hiring and other operational expenditures related to product and services sales. Such increases may be partially offset by increased sales of our value added products and services, as their related cost of revenues is generally lower. In 2014 our gross margin decreased, primarily due to inventory write-offs of \$3.4 million due to product cycle replacement. Specifically in 2014 we launched the service gateway TERA and reduced the level of inventories related to the old product lines. In 2015 our gross margin decreased, primarily due to intangible assets impairment of \$5.8 million derived from Oversi's and Ortiva's technologies acquired in 2012 due to our decision to reach end of life on the respective product lines. In 2016 we recorded no intangible assets impairment and as a result our gross margin increased compared to 2015.

#### Operating expenses

Research and development. Our research and development expenses consist primarily of salaries and related personnel costs, costs for subcontractor services, depreciation, rent and costs of materials consumed in connection with the design and development of our products. We expense all of our research and development costs as they are incurred. Our net research and development expenses are comprised of gross research and development expenses offset by financing through grants from the Israel Innovation Authority. Such participation grants are recognized at the time at which we are entitled to such grants on the basis of the costs incurred and included as a deduction of research and development expenses (see - “Government Grants” below). We believe that significant investment in research and development, including hiring high quality research and development personnel, is essential to our future success.

Sales and marketing. Our sales and marketing expenses consist primarily of salaries and related personnel costs, travel expenses, costs associated with promotional activities such as public relations, conventions and exhibitions, rental expenses, depreciation and commissions paid to third parties, promote our brand, establish new marketing channels and expand our presence worldwide.

General and administrative. Our general and administrative expenses consist of salaries and related personnel costs, rental expenses, costs for professional services and depreciation. General and administrative expenses also include costs associated with corporate governance, tax and regulatory compliance, compliance with the rules implemented by the SEC, NASDAQ and the Tel-Aviv Stock Exchange (“TASE”) and premiums for our director and officer liability

insurance.

While we do not expect our operating expenses to increase in 2017, they may increase in future periods.

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### Financial income, net

Financial income, net consists primarily of interest earned on our cash balances and other financial investments, foreign currency exchange gains or losses, gains or losses resulting from the sale of marketable securities and bank fees.

In 2014, we had \$0.7 million financial income, net. In 2015, we had \$0.6 million financial expenses, net. The change in 2015 was primarily attributed to foreign currency exchange losses. In 2016, we had \$1.1 million financial income, net. The change in 2016 was primarily attributed to interest earned on our cash balances and other financial investments.

In addition, financial income, net, may fluctuate due to foreign currency exchange gains or losses, as well as interest rate changes. See “—Factors Affecting Our Performance.”

### Approved Enterprise

Our facilities in Hod-Hasharon, Israel have been granted Approved Enterprise status under the Encouragement of Capital Investments Law, 1959, and enjoy certain tax benefits under this program. We expect to utilize these tax benefits after we utilize our net operating loss carry forwards. As of December 31, 2016, our net operating loss carry forwards for Israeli tax purposes totaled approximately \$46.6 million, which includes losses related to our acquisition of Oversi. As a result of our acquisition of Oversi, we may offset operating losses in Israel against taxable income annually with a limitation of up to 14% of the total accumulated loss but no more than 50% of our taxable income. Income derived from other sources, other than through our “Approved Enterprise” status, during the benefit period will be subject to the regular corporate tax rate.

### Government Grants

Our research and development efforts have been financed, in part, through grants from the Israel Innovation Authority under our approved plans in accordance with the Research and Development Law. In 2014, 2015 and 2016 we received grants from the Israel Innovation Authority through non-royalty bearing programs.

### Factors Affecting Our Performance

Our business, financial position and results of operations, as well as the period-to-period comparability of our financial results, are significantly affected by a number of factors, some of which are beyond our control, including:

**Customer concentration.** We derived 42% of our total revenues in 2016 from two global Tier 1 mobile and fixed operator groups. While we have some visibility into the likely scope of the customers’ projects, our relationships are conducted solely on a purchase order basis and we do not have any commitment for future purchase orders from these customers. The loss of any of such significant customers could harm our results of operations and financial condition.

**Size of end-customers and sales cycles.** We have a global, diversified end-customer base consisting primarily of service providers and enterprises. The deployment of our products by small and midsize enterprises and service providers can be completed relatively quickly. Large service providers take longer to plan the integration of our solutions into their existing networks and to set goals for the implementation of the technology. Sales to large service providers are therefore more complicated as they involve a relatively larger number of network elements and solutions. We are seeking to achieve further significant customer wins in the large service provider market that would positively impact our future performance. The longer sales cycles associated with the increased sales to large service providers of our platforms may increase the unpredictability of the timing of our sales and may cause our quarterly and annual operating results to fluctuate if a significant customer delays its purchasing decision and/or defers an order. Furthermore, longer sales cycles may result in delays from the time we increase our operating expenses and make



investments in inventory to the time that we generate revenue from related product sales.

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**Average selling prices.** Our performance is affected by the selling prices of our products. We price our products based on several factors, including manufacturing costs, the stage of the product's life cycle, competition, technical complexity of the product, and discounts given to channel partners in certain territories. We typically are able to charge the highest price for a product when it is first introduced to the market. We expect that the average selling prices for our products will decrease over the product's life cycle as our competitors introduce new products. In order to maintain or increase our current prices, we expect that we will need to enhance the functionality of our existing products by offering higher system speeds, additional value-added products and features, such as additional security functions, supporting additional applications and providing enhanced reporting tools. We also from time to time introduce enhanced products, typically higher-end models that include new architecture and design and new capabilities. Such enhanced products typically increase our average selling price. To further offset such declines, we sell maintenance and support programs for our products, and as our customer base and number of field installations grow, our related service revenues are expected to increase.

**Cost of revenues and cost reductions.** Our cost of revenues as a percentage of total revenues was 29.7% for 2014, 33.4% for 2015 and 30.9% for 2016. Our products use off-the-shelf components and typically the prices of such components decline over time. However, the introduction and sale of new or enhanced products and services may result in an increase in our cost of revenues. We make a continuous effort to identify cheaper components of comparable performance and quality. We also seek improvements in engineering and manufacturing efficiency to reduce costs. Our products incorporate features that are purchased from third parties. In addition, new products usually have higher costs during the initial introduction period. We generally expect such costs to decline as the product matures and sales volume increases. The introduction of new products may also involve a significant decrease in demand for older products. Such a decrease may result in a devaluation or write-off of such older products and their respective components. In 2014, we recorded a write-off of \$3.4 million of inventory to our cost of revenues, due to product cycle replacement. Specifically in 2014 we launched the service gateway TERA that supersedes the service gateway Sigma and Sigma E and as a result of the faster than anticipated adoption, we reduced the level of inventories related to the old product lines. The growth of our customer base is usually coupled with increased service revenues primarily resulting from increased maintenance and support. In addition, the growth of our installed base with large service providers may result in increased demand for professional services, such as training and installation services. An increase in demand for such services may require us to hire additional personnel and incur other expenditures. However, these additional expenses, handled efficiently, may be utilized to further support the growth of our customer base and increase service revenues. The increase of our cost of revenues in 2015 was primarily due to intangibles assets impairment of \$5.8 million derived from Oversi's and Ortiva's technologies acquired in 2012 due to our decision to phase out the respective product lines. In 2016 we recorded no intangible assets impairment and as a result our gross margin increased compared to 2015.

**Currency exposure.** A majority of our revenues and a substantial portion of our expenses are denominated in the U.S. dollar. However, a significant portion of our revenues is incurred in currencies other than U.S. dollar, mostly in Euro. In addition, a significant portion of our expenses, associated with our global operations, including personnel and facilities-related expenses, are incurred in currencies other than the U.S. dollar; this is the case primarily in Israel and to a lesser extent in other countries in Europe and Asia. Consequently, a decrease in the value of the U.S. dollar relative to local currencies will increase the dollar cost of our operations in these countries. A relative decrease in the value of the U.S. dollar would be partially offset to the extent that we generate revenues in such currencies. In order to partially mitigate this exposure we have decided in the past and may decide from time to time in the future to enter into hedging transactions. We may discontinue hedging activities at any time. As such decisions involve substantial judgment and assessments primarily regarding future trends in foreign exchange markets, which are very volatile, as well as our future level and timing of cash flows of these currencies, we cannot provide any assurance that such hedging transactions will not affect our results of operations when they are realized. See Note 5 to our consolidated financial statements included elsewhere in this annual report for further information. Also see "ITEM 11: Quantitative and Qualitative Disclosure About Market Risk."

Interest rate exposure. We have a significant amount of cash that is currently invested primarily in interest bearing vehicles, such as bank time deposits and available for sale marketable securities. These investments expose us to risks associated with interest rate fluctuations. See “ITEM 11: Quantitative and Qualitative Disclosure About Market Risk.”

## Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, or U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and judgments are subject to an inherent degree of uncertainty and actual results may differ. Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this annual report. Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. Those estimates are based on our historical experience, the terms of existing contracts, our observance of trends in our industry, information provided by our customers and information available from other outside sources, as appropriate. With respect to our policies on revenue recognition and warranty costs, our historical experience is based principally on our operations since we commenced selling our products in 1998. Our estimates are primarily guided by observing the following critical accounting policies:

- Revenue recognition;
- Provision for returns;
- Business combinations
- Allowance for doubtful accounts;
- Accounting for stock-based compensation;
- Inventories;
- Marketable securities;
- Impairment of goodwill and long lived assets;
- Income taxes; and
- Contingencies.

Because each of the accounting policies listed above requires the exercise of certain judgments and the use of estimates, actual results may differ from our estimations and as a result would increase or decrease our future revenues and net income.

**Revenue recognition.** We account for revenue recognition in accordance with Accounting Standards Codification No. 605-25, “Multiple elements arrangements” (“ASC No. 605-25”). We generate revenues mainly from selling our products along with related maintenance and support services. At times, these arrangements may also include professional services, such as installation services or training. We generally sell our products through resellers, distributors, OEMs and system integrators, all of whom are considered end-users.

Revenues from product sales are recognized when persuasive evidence of an agreement exists, title and risk of loss have transferred to the customer, no significant performance obligations remain, payment for products is not contingent upon performance of installation or service obligations, the fee is fixed or determinable and collectability is probable. In instances where final acceptance of the product or service is specified by the customer, we do not recognize the revenue until all acceptance criteria have been met.



Maintenance and support related revenues included in multiple element arrangements are deferred and recognized on a straight-line basis over the term of the applicable maintenance and support agreement. Other services, such as professional services, are recognized upon the completion of installation or when the service is provided. In instances where the services provided in a multiple element arrangement are considered essential to the functionality of the product and payment of the product is contingent upon performance of the services, the sales of the products and services would be considered one unit of accounting. Deferred revenues are classified as short and long term based on their contractual term and recognized as revenues at the time the respective elements are provided.

Revenues arrangements with multiple deliverables are allocated using the relative selling price method. The Company determines the best estimated selling price (“BESP”) in multiple elements arrangements as follows:

For the products, we determined the “BESP” based on management’s estimated selling price by reviewing historical transactions and considering multiple other factors, including but not limited to, pricing practices including discounting, and competition.

For the maintenance and support, the Company determined BESP based on VSOE of the price charged based on standalone sales (renewals) of such elements using a consistent percentage of the Company's product price lists in the same territories.

Provision for returns. We provide a provision for product returns based on its experience with historical sales returns. Such provisions amounted to \$0.9 million, \$0.7 million and \$1.1 million as of December 31, 2016, 2015 and 2014, respectively.

Business combinations. We account for our business acquisitions in accordance with Accounting Standards Codification (ASC) No. 805, Business Combinations. We use management best estimates and assumptions as part of the purchase price allocation process to value assets acquired and liabilities assumed at the business combination date. The total purchase price allocated to the tangible assets acquired is assigned based on the fair values as of the date of the acquisition.

Allowance for doubtful accounts. We evaluate the collectability of our accounts receivable on a specific basis. We estimate this allowance based on our judgment as to our ability to collect outstanding receivables. We primarily base this judgment on an analysis of significant outstanding invoices, the age of the receivables, our historical collection experience and current economic trends. In circumstances where we are aware of a specific customer’s inability to meet its financial obligations to us, we record a specific allowance against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected.

Accounting for stock-based compensation. We account for stock-based compensation in accordance with Accounting Standards Codification No. 718, “Compensation - Stock Compensation” (“ASC No. 718”) that 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 our consolidated statement of operations. We recognize compensation expense for the value of its awards granted based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC No. 718 requires forfeitures to be estimated at the time of the grant and revised in subsequent periods if actual forfeitures differ from those estimates.

In connection with the grant of options and RSUs, we recorded total stock-based compensation expenses of \$8.1 million in 2014, \$7.2 million in 2015, and \$5.1 million in 2016. In 2016, \$0.4 million, \$1.2 million, \$1.8 million and \$1.7 million of our stock-based compensation expense resulted from cost of revenue, research and development expenses, net, sales and marketing expenses and general and administrative expenses, respectively, based on the department in which the recipient of the option grant was employed. As of December 31, 2016, we had an aggregate of \$5.0 million of unrecognized stock-based compensation remaining to be recognized over a weighted average

vesting period of 2.3 years.

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Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventory and discontinued products. Inventory write-off provision as of December 31, 2016, 2015 and 2014 totaled \$2.0 million, \$1.7 million, and \$4.5 million, respectively.

Marketable securities. We account for our investments in marketable securities using Accounting Standards Codification No. 320, "Investments – Debt and Equity Securities" ("ASC No. 320").

We determine the appropriate classification of marketable securities at the time of purchase and evaluate such designation as of each balance sheet date. We classify all of our investments in marketable securities as available for sale. Available for sale securities are carried at fair value, with unrealized gains and losses reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sales of investments are included in earnings and are derived using the specific identification method for determining the cost of securities. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization together with interest and dividends on securities are included in financial income, net, if any.

As of December 31, 2016, we held available for sale marketable securities of \$60.5 million. As of December 31, 2016, the unrealized loss recorded in other comprehensive income was \$0.1 million.

Impairment of goodwill and long lived assets. Goodwill represents the excess of the purchase price over the fair value of net assets of purchased businesses. Under Accounting Standards Codification No. 350, "Intangibles-Goodwill and Other" ("ASC No. 350"), goodwill and intangible assets deemed to have indefinite lives are tested for impairment annually, or more often if there are indicators of impairment present.

We perform an annual impairment analysis of goodwill at December 31 of each year, or more often as applicable. We operate in one operating segment, and this segment comprises only one reporting unit. The provisions of ASC No. 350 require that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, we compare the fair value of the reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and no further testing is required to be performed. If the carrying value of the net assets exceeds the fair value, then we must perform the second step of the impairment test in order to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference.

We believe that our business activity and management structure meet the criterion of being a single reporting unit for accounting purposes. We performed an annual impairment analysis as of December 31, 2016 and determined that the carrying value of the reporting unit was more than the fair value of the reporting unit. Fair value is determined using market capitalization. During the years ended 2014, 2015 and 2016, no impairment losses were recorded.

Intangible assets acquired in a business combination are recorded at fair value at the date of the acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets that are not considered to have an indefinite useful life are amortized over their estimated useful lives. Some of the acquired intangible assets are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in accelerated amortization of such customer relationships and backlog as compared to the straight-line method. All other intangible assets are amortized over their estimated useful lives on a straight-line basis.



Property and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with ASC No. 360, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset 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. During 2016, no impairment losses in respect of intangible assets were recorded. During 2015, we recorded impairment losses of \$5.8 million in respect of intangible assets. During 2014, no such impairment losses were recorded.

Income taxes. We account for income taxes in accordance with Accounting Standards Codification No. 740, "Income Taxes" ("ASC No. 740"). ASC No. 740 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. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

In Israel, we have accumulated operating loss carry forwards of approximately \$46.6 million and capital losses of approximately \$27.3 million for tax purposes as of December 31, 2016, which may be carried forward and offset against taxable capital gains in the future for an indefinite period. In the United States, the accumulated losses for U.S. federal income tax return purposes were approximately \$5.5 million as of December 31, 2016, and expire between 2026 and 2032. We believe that because of our history of losses, and uncertainty with respect to future taxable income, it is more likely than not that some of the deferred tax assets regarding the loss carry forwards will not be utilized in the foreseeable future, and therefore, a valuation allowance was provided to reduce deferred tax assets to their realizable value. The valuation allowance for the year ended December 31, 2016 was \$14.7 million.

ASC No. 740 contains a two-step approach to recognizing and measuring a liability for 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% likely to be realized upon ultimate settlement.

Contingencies. From time to time, we are a defendant or plaintiff in various legal actions, which arise in the normal course of business. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required for these contingencies, if any, which would impact our results of operations, is made after considered analysis of each individual action together with our legal advisors. The required reserves may change in the future due to new developments in each matter or changes in circumstances and estimations. A change in the required reserves would impact our results of operations in the period the change is made.

For more information regarding recently issued accounting pronouncements see note 2 to the Financial Statements.

## Results of Operations

The following table sets forth our statements of operations as a percentage of revenues for the periods indicated:

	Year Ended December 31,		
	2014	2015	2016
Revenues:			
Products	65.9 %	62.7 %	60.2 %
Services	34.1	37.3	39.8
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Products	23.4	26.7	22.6
Services	6.3	6.7	8.3
Total cost of revenues	29.7	33.4	30.9
Gross profit	70.3	66.6	69.1
Operating expenses:			
Research and development, net	24.8	26.4	26.8
Sales and marketing	38.1	43.3	39.1
General and administrative	10.2	12.7	10.9
Total operating expenses	73.1	82.4	76.7
Operating loss	2.7	15.8	7.6
Financing income (expenses), net	0.6	(0.6 )	1.2
Loss before income tax expense	2.1	16.4	6.4
Income tax (expense) benefit	0.0	(3.4 )	(2.4 )
Net loss	2.1 %	19.8 %	8.8 %

## Revenues

The following table sets forth a breakdown of our revenues by geographic locations for the periods indicated:

	Revenues by Location					
	2016		2015		2014	
	\$	%	\$	%	\$	%
	Revenues		Revenues		Revenues	
	(\$ in thousands)					
Revenues:						
Europe	\$34,279	38 %	\$39,110	39 %	\$41,238	35 %
Asia and Oceania	27,700	31 %	28,495	29 %	41,990	36 %
Middle East and Africa	12,365	14 %	9,809	10 %	15,352	13 %
United States	2,931	3 %	8,206	8 %	15,307	13 %
Americas (excluding United States)	13,094	14 %	14,347	14 %	3,299	3 %
Total Revenues	\$90,369	100 %	\$99,967	100 %	\$117,186	100 %

## Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

## Revenues

Products. Product revenues decreased by \$8.2 million, or 13.1%, to \$54.4 million in 2016 from \$62.6 million in 2015. The decrease in revenues in 2016 was attributable to a decrease in the number of transactions with large Tier-1 operators compared to 2015 and the sharp decrease in the EUR and other currencies against the U.S. dollar.



Services. Service revenues decreased by \$1.4 million, or 3.7%, to \$35.9 million in 2016 from \$37.3 million in 2015. A material part of the sales of our Services is linked to the sales of our Products, which decreased due to the factors described above. Such factors also contributed to the decrease in Services revenues.

Product revenues comprised 60.2% of our total revenues in 2016, a decrease of 2.4% compared to 2015 while the services revenues portion of total revenues increased by 2.4%.

#### Cost of revenues and gross margin

Products. Cost of product revenues decreased by \$6.3 million, or 23.6%, to \$20.4 million in 2016 from \$26.7 million in 2015. Product gross margin increased to 62.5% in 2016 from 57.4% in 2015. The decrease of our cost of product revenues in 2016 was a mainly the result of an intangible assets impairment of \$5.8 million in 2015 derived from Oversi's and Ortiva's technologies acquired in 2012 due to our decision to reach end of life on the respective product lines<sup>1</sup>.

Services. Cost of services revenues increased by \$0.8 million, or 11.5%, to \$7.5 million in 2016 from \$6.7 million in 2015. This increase was attributed to additional personnel hiring and increase in operational expenditures related to service sales.

Total gross margin, increased to 69.1% in 2016 from 66.6% in 2015.

#### Operating expenses

During 2016, the Company endeavored to reduce its operating expenses by decreasing, among others, its head count and other operating expenses.

Research and development. Gross research and development expenses decreased by \$2.8 million, or 10.3%, to \$24.8 million in 2016 from \$27.7 million in 2015. Research and development expenses as a percentage of total revenues increased to 27.5% in 2016 from 27.7% in 2015.

Sales and marketing. Sales and marketing expenses decreased by \$8.0 million, or 18.5%, to \$35.3 million in 2016 from \$43.3 million in 2015.

Sales and marketing expenses as a percentage of total revenues decreased to 39.1% in 2016 from 43.3% in 2015.

General and administrative. General and administrative expenses decreased by \$2.9 million, or 22.8%, to \$9.8 million in 2016 from \$12.7 million in 2015.

General and administrative expenses as a percentage of revenues decreased to 10.9% in 2016 from 12.7% in 2015.

Financial income, net. In 2016 we had \$1.1 million financial income, net, and in 2015, we had \$0.6 million financial expenses, net. The change in 2016 was primarily attributed to interest earned on our cash balances and other financial investments.

Income tax expense. Income tax expense in 2016 was \$2.2 million, compared to income tax expense of \$3.4 million in 2015. This decrease was due to a write-off of \$2.1 million of deferred tax assets done in 2015, which was offset by an increase in write-off of unutilized withholding taxes of \$0.6 million in 2016.

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

## Revenues

**Products.** Product revenues decreased by \$14.6 million, or 18.9%, to \$62.6 million in 2015 from \$77.2 million in 2014. The decrease in revenues in 2015 was attributable to longer conversion cycles of bookings into revenues, mainly with respect to bookings from new customers, the sharp decrease in Euro and other currencies against the U.S. dollar, and a decrease in the number of transactions with large Tier-1 operators up-scaling their equipment, compared to previous year.

**Services.** Service revenues decreased by \$2.6 million, or 6.6%, to \$37.3 million in 2015 from \$39.9 million in 2014. The decrease in services revenues is primarily attributable to decrease in product revenue.

Product revenues comprised 62.7% of our total revenues in 2015, a decrease of 3.2% compared to 2014 while the services revenues portion of total revenues increased by the same percentage.

## Cost of revenues and gross margin

**Products.** Cost of product revenues decreased by \$0.7 million, or 2.5%, to \$26.7 million in 2015 from \$27.4 million in 2014. Product gross margin, decreased to 57.4% in 2015 from 64.5% in 2014. The decrease of our cost of product revenues in 2015 was in correlation with the decrease in product revenues, which was compensated by an intangible assets impairment of \$5.8 million derived from Oversi's and Ortiva's technologies acquired in 2012 due to our decision to reach end of life on the respective product lines.

**Services.** Cost of services revenues decreased by \$0.6 million, or 8.6%, to \$6.7 million in 2015 from \$7.3 million in 2014. This decrease is consistent with the decrease in services revenues.

Total gross margin, decreased to 66.6% in 2015 from 70.4% in 2014

## Operating expenses

**Research and development.** Gross research and development expenses decreased by \$2.3 million, or 7.7%, to \$27.7 million in 2015 from \$30.0 million in 2014. This decrease is primarily attributable to a decrease in salaries and related expenses of approximately \$1.7 million and a decrease in other overhead expenses of approximately \$0.5 million.

Research and development expenses, as a percentage of total revenues increased to 26.4% in 2015 from 24.8% in 2014.

**Sales and marketing.** Sales and marketing expenses decreased by \$1.3 million, or 2.9%, to \$43.3 million in 2015 from \$44.6 million in 2014. This decrease is primarily attributable to decrease in commission expenses of approximately \$1.0 million, and decrease in salary expenses of approximately \$0.3 million.

Sales and marketing expenses, as a percentage of total revenues increased to 43.3% in 2015 from 38.1% in 2014.

**General and administrative.** General and administrative expenses increased by \$0.8 million, or 6.4%, to \$12.7 million in 2015 from \$11.9 million in 2014. This increase is primarily attributable to increase in bad debt expense of approximately \$0.7 million.

General and administrative expenses as a percentage of revenues increased to 12.7% in 2015 from 10.2% in 2014.

Financial income, net. In 2015 we had \$0.6 million financial expenses, net, in 2014, we had \$0.7 million financial income, net. The change in 2015 was primarily attributed to foreign currency exchange losses.

Income tax expense. Income tax expense in 2015 was \$3.4 million, compared to income tax expense of \$0.05 million in 2014. This decrease is due to realization of deferred tax assets of \$0.7 million and write-off of \$2 million of deferred and pre-paid tax assets, as well as \$0.5 million write-off of unutilized withholding taxes as it is more likely than not that these assets will not be utilized in the foreseeable future.

## B. Liquidity and Capital Resources

As of December 31, 2016, we had \$23.3 million in cash and cash equivalents, \$60.5 million available for sale marketable securities and \$29.8 million in short-term deposits. As of December 31, 2016, our working capital, which we calculate by subtracting our current liabilities from our current assets, was \$123.9 million.

Based on our current business plan, we believe that our existing cash balances will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. If our estimates of revenues, expense or capital or liquidity requirements change or are inaccurate and are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or arrange additional debt financing. In addition, we may seek to sell additional equity or arrange debt financing to give us financial flexibility to pursue attractive acquisitions or investment opportunities that may arise in the future.

### Operating activities.

During 2016, we used \$3.5 million in cash and cash equivalents from operating activities. Net cash used in operating activities consisted mainly of a net loss of \$8.0 million, depreciation, amortization and impairment of intangible assets of \$4.0 million, \$5.1 million of stock-based compensation expense, a decrease of \$2.9 million in inventory, a decrease of \$0.8 million in employees and payroll accruals, an increase of \$0.3 million in trade receivables, a decrease of \$4.2 million in deferred revenues attributed to sales which revenue recognition criteria were met while cash was collected in the previous years, a decrease of \$3.8 million in trade payables, a decrease of \$0.2 million in long-term deferred taxes, net, a decrease of \$0.7 million in other receivables and prepaid expenses and \$0.7 million related to other operating activities.

Net cash we provided in operating activities in 2015 was \$4.2 million. Net cash provided in operating activities consisted mainly of a net loss of \$19.8 million, depreciation, amortization and impairment of intangible assets of \$11.5 million, \$7.2 million of stock-based compensation expense, an increase of \$0.06 million in inventory, an increase of \$0.9 million in employees and payroll accruals, an increase of \$0.8 million in trade receivables, an increase of \$2.0 million in deferred revenues attributed to sales which revenue recognition criteria were met while cash was collected in the previous years, an increase of \$2.2 million in trade payables, a decrease of \$1.4 million in long-term deferred taxes, net, an increase of \$2.6 million in other receivables and prepaid expenses and \$2.4 million related to other operating activities.

During 2014, we provided \$15.8 million in cash and cash equivalents from operating activities. Net cash provided in operating activities consisted mainly of a net loss of \$2.5 million, depreciation and amortization of intangible assets of \$5.2 million, \$8.1 million of stock-based compensation expense, a decrease of \$3.7 million in inventory, an increase of \$1.1 million in employees and payroll accruals, an increase of \$6.9 million in trade receivables, an increase of \$1.9 million in deferred revenues attributed to sales which revenue recognition criteria were met while cash was collected in the previous year, an increase of \$3.1 million in trade payables and \$2.1 million related to other operating activities.

### Investing activities.

Net cash provided by investing activities in 2016 was \$15.0 million, primarily attributable to an investment in available-for sale marketable securities of \$29.7 million and the purchase of property and equipment of \$1.6 million. The above changes were partially offset by redemption of marketable securities of \$33.2 million and redemptions of short-term bank deposits of \$12.9 million.





Net cash used by investing activities in 2015 was \$7.9 million, primarily attributable to acquisitions of \$9.9 million, an investment in available-for sale marketable securities of \$34.1 million and the purchase of property and equipment of \$2.2 million. The above changes were partially offset by redemption of marketable securities of \$22.2 million and redemptions of short-term bank deposits of \$16.3 million.

Net cash used in investing activities in 2014 was \$40.9 million, primarily attributable to the investments of short-term bank deposits of \$21.0 million, an investment in available-for sale marketable securities of \$22.7 million and the purchase of property and equipment of \$3.4 million and a loan granted to a third party of \$2.1 million. The above changes were partially offset by redemption of marketable securities of \$8.2 million.

We expect that our capital expenditures will total approximately \$2.9 million in 2017. We anticipate that these capital expenditures will be primarily related to further investments in lab equipment for research and development and for leasehold improvements.

Financing activities.

Net cash used in financing activities in 2016 was \$3.7 million, which was attributable to issuance of share capital through the exercise of stock options and RSUs of \$0.1 million and repurchase of our ordinary shares of \$3.8 million.

Net cash used in financing activities in 2015 was \$0.03 million, which was attributable to issuance of share capital through the exercise of stock options and RSUs of \$0.13 million and repurchase of our ordinary shares of \$0.17 million.

Net cash provided by financing activities in 2014 was \$1.5 million, which was attributable to issuance of share capital through the exercise of stock options and RSUs of \$1.5 million.

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

In previous years, our research and development efforts have benefited from royalty-bearing grants from the Israel Innovation Authority. In 2014, 2015 and 2016, we benefited from non-royalty bearing grants from the Israel Innovation Authority. The government grants we have received for research and development expenditures restrict our ability to manufacture products and transfer technologies outside of Israel and require us to satisfy specified conditions. If we fail to comply with such restrictions or these conditions, we may be required to refund grants previously received together with interest and penalties, and may be subject to criminal charges.

In addition to our membership in a Magnet consortium which was approved prior to 2014, in 2014 we were also qualified to participate in one research and development program funded by the Israel Innovation Authority to develop generic technology relevant to the development of our products. Such program is approved pursuant to the Research and Development Law, and the regulations promulgated thereunder. The program is for companies with large research and development activities. We were eligible to receive non-royalty-bearing grants constituting between 40% and 55% of certain research and development expenses relating to this program. Although the grants under these programs are not required to be repaid by way of royalties, the restrictions under the Research and Development Law described above apply to these programs.

Total research and development expenses, before royalty bearing grants, were approximately \$30.0 million, \$27.7 million and \$24.8 million in the years ended December 31, 2014, 2015 and 2016, respectively. Non-royalty-bearing grants amounted to \$1.0 million, \$1.3 million and \$0.6 million in 2014, 2015 and 2016, respectively.

As of December 31, 2016, we had twenty two issued U.S. patents and two pending patent applications in the United States. We expect to formalize our evaluation process for determining which inventions to protect by patents or other means. We cannot be certain that patents will be issued as a result of the patent applications we have filed.



## D. Trend Information

See “ITEM 5: Operating and Financial Review and Prospects” above.

## E. Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

## F. Contractual Obligations

The following table of our material contractual and other obligations known to us as of December 31, 2016, summarizes the aggregate effect that these obligations are expected to have on our cash flows in the periods indicated.

Contractual Obligations	Payments due by period			
	Total	Less than 1 year	1–3 years	Over 3 years
	(in thousands of U.S. dollars)			
Operating leases —offices(1)	\$3,307	\$ 2,458	\$ 833	16
Operating leases —vehicles	478	267	211	-
Accrued severance pay(2)	286	-	-	286
Total	\$4,071	\$ 2,725	\$ 1,044	\$ 302

(1) Consists primarily of an operating lease for our facilities in Hod Hasharon, Israel, as well as operating leases for facilities leased by our subsidiaries.

Severance pay relates to accrued severance obligations to our Israeli employees as required under Israeli labor law.

(2) These obligations are payable only upon termination, retirement or death of the respective employee and there is no obligation if the employee voluntarily resigns. Of this amount, \$33 thousands is unfunded.

## ITEM 6: Directors, Senior Management and Employees

## A. Directors and Senior Management

The following table sets forth the names, ages and positions of our directors and executive officers as of March 1, 2017:

Name	Age	Position
<u>Directors</u>		
Yigal Jacoby(5)	56	Chairman of the Board
Rami Hadar	54	Director
Itzhak Danziger (5)	68	Director
Nurit Benjamini(1)(2)(3) (4)(5)	50	Director
Steven D. Levy(1)(2) (4)(5)	61	Director
Miron (Ronnie) Kenneth (1)(2) (5)	61	Director
Nadav Zohar(5)*	51	Director
<u>Executive Officers</u>		
Erez Antebi	58	Chief Executive Officer and President
Alberto Sessa	55	Chief Financial Officer
Amir Hochbaum	58	Vice President, Research and Development
Anat Shenig	48	Vice President, Human Resources
Ronen Priel	41	VP Product Management & Marketing
Rael Kolevsohn	47	Vice President, Legal Affairs, General Counsel and Company Secretary
Pini Gvili	52	Vice President, Operations
Yossi Abraham	45	Vice President, Business Development
Shaked Levy	42	Vice President, VP Global Business & Customer Success

(1) Member of our compensation and nomination committee.

(2) Member of our audit committee.

(3) Lead independent director.

(4) Outside director.

(5) Independent director under the rules of NASDAQ.

\* Mr. Zohar serves as an interim director appointed by our Board of Directors effective February 6 2017, to serve until the date of the next Annual General Meeting of Shareholders. In the event that his nomination is not approved and he is not re-elected as a director by our shareholders at the Company's next Annual General Meeting of Shareholders, he will no longer serve on the Board, following such meeting.

## Directors

Yigal Jacoby has served as Chairman of the Board of Directors since November, 2016. Mr. Jacoby co-founded our company in 1996 and served as our CEO until 2006 and as a Chairman of our board of directors until 2008. Prior to co-founding Allot, Mr. Jacoby founded Armon Networking, a manufacturer of network management solutions in 1992, and managed it until it was acquired by Bay Networks, where he served as the General Manager of its Network Management Division. From 1985 to 1992, Mr. Jacoby held various engineering and marketing management positions at Tekelec, a manufacturer of Telecommunication monitoring and diagnostic equipment. Currently, Mr. Jacoby is an active investor and director of several Israeli start-up companies, including serving as Chairman at LiveU Ltd., a provider of live cellular video transmission solutions. Mr. Jacoby has a B.A., cum laude, in Computer Science from Technion — Israel Institute of Technology and an M.Sc. in Computer Science from University of Southern California.

Rami Hadar has served as a director since 2006 and served as our Chief Executive Officer and President from 2006 to 2014. Prior to joining us, Mr. Hadar founded CTP Systems, a developer of cordless telephone systems in 1989 and served as Chief Executive Officer until its acquisition by DSP Communications in 1995. Mr. Hadar continued with DSP Communication's executive management team for two years, and thereafter, in 1999, the company was acquired by Intel. In 1997, Mr. Hadar co-founded Ensemble Communications, a pioneer in the broadband wireless space and the WiMax standard, where he served as Executive Vice President of Sales and Marketing until 2002. Mr. Hadar also served as Chief Executive Officer of Native Networks from 2002 to 2005, which was successfully sold and integrated to Alcatel. Mr. Hadar holds a B.Sc. in Electrical Engineering from Technion — Israel Institute of Technology. Since May 2015, Mr. Hadar has served as Managing General Partner of Euclyptus Growth Capital, an Israeli growth capital fund, focusing on investing and helping late stage Israeli companies grow their business, penetrate international markets and achieve successful IPO's as part of their growth.

Itzhak Danziger has served as a director since 2011. Prior to his appointment as a director, Mr. Danziger served as an observer to our Board since 2010. Itzhak Danziger serves as a member of the board of Galil Software, an Israeli software services company, and as a director of Jinni Media, a privately held technology company. From 1985 to 2007, Mr. Danziger held various executive positions at Comverse, a technology companies group that develops and markets telecommunications systems, including as president of Comverse Technology Group, as president of Comverse Network Systems and as chairman of Comverse subsidiary - Starhome. Prior to joining Comverse, Mr. Danziger held various R&D and management positions in Tadiran Telecom Division, which was later acquired by ECI Telecom. In the non-profit sector, Mr. Danziger serves as a the chairman of the Center for Educational Technology (CET), as Vice President of the New Israel Fund (NIF), a director in Israel Venture Networks (IVN), a director in Israel Venture Network (IVN) , a venture philanthropy NGO, in Avney Rosha, the Israel Institute for School Leadership, and in other non-governmental organizations. Mr. Danziger was also a member of the National Task Force for the Advancement of Education in Israel (Dovrat Committee) and was chairman of two of its subcommittees. Mr. Danziger holds a B.Sc. cum laude and an M.Sc. in electrical engineering from the Technion - Israel Institute of Technology and an M.A. cum laude in philosophy and digital culture from Tel Aviv University.

Nurit Benjamini has served as an outside director since 2007 and serves as the lead independent director on our board. Since December 2013, Ms. Benjamini has served as the Chief Financial Officer of TabTale Ltd. a company that provides mobile content . Ms. Benjamini served as the Chief Financial Officer of Wix.com, an internet company that offers technology, which makes it easy for all users to get online and create professional and functional web presence, from 2011 to 2013. Previously, from 2007 to 2011, Ms. Benjamini has served as the Chief Financial Officer of CopperGate Communications Ltd. that was acquired by Sigma Designs Inc. (NASDAQ:SIGM) in November 2009. Prior to her position with CopperGate Communications Ltd., Ms. Benjamini served as the Chief Financial Officer of Compugen Ltd. (NASDAQ: CGEN) from 2000 to 2007. Prior to her position with Compugen Ltd., from 1998 to 2000, Ms. Benjamini served as the Chief Financial Officer of Phone-Or Ltd. Between 1993 and 1998, Ms. Benjamini served as the Chief Financial Officer of Aladdin Knowledge Systems Ltd. (formerly NASDAQ: ALDN). Ms. Benjamini serves as an outside director of BiolineRX Ltd. (NASDAQ: BLRX), a member of its compensation committee, and as a chairman of its audit committee. Ms. Benjamini serves as a director and chair-person of the audit committee of Redhill Biopharma (NASDAQ/TASE: RDHL). Ms. Benjamini holds a B.A. in Economics and Business and an M.B.A. in Finance, both from Bar Ilan University, Israel.

Steven D. Levy has served as an outside director since 2007. Mr. Levy served as a Managing Director and Global Head of Communications Technology Research at Lehman Brothers from 1998 to 2005. Before joining Lehman Brothers, Mr. Levy was a Director of Telecommunications Research at Salomon Brothers from 1997 to 1998, Managing Director and Head of the Communications Research Team at Oppenheimer & Co. from 1994 to 1997 and a senior communications analyst at Hambrecht & Quist from 1986 to 1994. Mr. Levy has served as a director of PCTEL, a broadband wireless technology company since January 2006 and of privately held GENBAND Inc., a U.S. provider of telecommunications equipment, since August 2007. Mr. Levy holds a B.Sc. in Materials Engineering and an M.B.A., both from the Rensselaer Polytechnic Institute.

Miron (Ronnie) Kenneth has served as a director since October 2014. Mr. Kenneth has more than 20 years of experience in the global high technology business, and is currently a private investor in high technology startups. He serves as the Chairman of Teridion Technologies Ltd., a privately held company specializing in overlay network technologies for service providers. From May 2011 to May 2013, Mr. Kenneth served as the CEO of Pontis Ltd., a privately-held company specializing in providing online marketing and analytics platforms for service providers. Prior to his tenure at Pontis, Mr. Kenneth was the Chairman and Chief Executive Officer of Voltaire Technologies Ltd. (from January 2001 to 2011). In 2011 Voltaire was acquired by Mellanox Technologies Ltd. (NASDAQ: MLNX). Prior to his employment at Voltaire, Mr. Kenneth was a General Partner in Telos Venture Partners, a Silicon Valley based venture firm. Prior to Telos, Mr. Kenneth also held senior management positions in Cadence Design Systems Inc.'s (NASDAQ: CDN) European organization. Mr. Kenneth has an M.B.A. from Golden Gate University in San Francisco, California and a B.A. in Economics and Computer Science from Bar Ilan University in Israel.

Nadav Zohar, has served as an interim director since February 2017. Mr. Zohar serves as the head of Business Development of Gett, an “on demand” transportation service provider. Prior to joining Gett, Mr. Zohar served as Chief Operating Officer of Delek Global Real Estate PLC between 2006 and 2009 and held several executive positions with Morgan Stanley, between 2001 and 2006, the last of which was Executive Director, Financial Sponsors Group. Prior to joining Morgan Stanley, Mr. Zohar served in executive roles at Lehman Brothers between 1997 and 2001. Mr. Zohar serves as a board member of Matomy Media Group Ltd. (London Stock Exchange: MTMY), a digital performance-based advertising company. Mr. Zohar holds a Masters in Finance (graduated with Merit) from the London Business School and a LLB in Law (graduated with honors) from the University of Reading.

## Executive Officers

Erez Antebi has served as our President and Chief Executive Officer since February 2017. Mr. Antebi served as the CEO of Gilat Satellite Networks (NASDAQ: GILT), a satellite communications technology and services provider, between 2012 and 2015. Between 2005 and 2012 Mr. Antebi also served in several executive roles at Gilat Satellite Networks. Between 2003 and 2005 Mr. Antebi served as the CEO of Clariton Networks, a start-up company, providing services in cellular coverage. Prior to that Mr. Antebi has served in a variety of roles at Gilat Satellite Networks, Tadiran, a provider of radio communications for military applications and for Rafael, Israel Ministry of Defense. Mr. Antebi currently serves on the board and advisory boards of several companies, including Effective Sapce Services, NSL, HiSky, Xinow and LiveU. Mr. Antebi holds a B. Sc., Electrical Engineering (Communications), Summa Cum Laude, and a M.Sc., Electrical Engineering (Information Theory), both from the Technion, Israel.

Alberto Sessa has served as our Chief Financial Officer since January 2017. Prior to joining Allot, since 2009, Mr. Sessa served as the CFO of Flash Networks, a leading provider of optimization solutions. Prior to joining Flash, between 2007 and 2009 Mr. Sessa served as the CFO of ARA Minerals. He also served as Vice President, Finance at Amdocs Management Ltd. between 2000 and 2007. Between 1996 and 1999, Mr. Sessa served as Group Corporate CFO at a privately held international group of companies. Mr. Sessa holds a B.A. in Statistics and Economics and an M.B.A., both from the Hebrew University in Jerusalem.

Amir Hochbaum has served as our Vice President—Research and Development since 2008. Before joining Allot, Mr. Hochbaum served as the Chief Operating Officer of Axerra Networks. From 2005 to 2007, Mr. Hochbaum was Senior Vice President, Research, Development and Operations of Vyyo Israel (NASDAQ: VYYO) where he also served as a member of Vyyo's executive management team. Prior to Vyyo, between 1994 and 2005, Mr. Hochbaum held a succession of management positions at Avaya (formerly Lucent, Madge and Lannet) including Managing Director and Vice President of R&D. Between 1984 and 1994, Mr. Hochbaum held a succession of management positions at ServiceSoft, including management of engineering, product development, product management and customer service. Mr. Hochbaum holds a B.S. in Mathematics and Computer Science and an M.S. in Computer Science, both from the Hebrew University of Jerusalem.

Anat Shenig joined our company in 2000 and has served as our Vice President—Human Resources since 2007. Ms. Shenig is responsible for human resources recruiting, welfare policy and employees' training. Prior to joining us, Ms. Shenig served as Human Resource Manager for Davidoff insurance company and as an organizational consultant for Aman Consulting. Ms. Shenig holds a B.A. in Psychology and Economics from Tel Aviv University and an M.B.A. in organizational behavior from Tel Aviv University.

Ronen Priel has served as Vice President—Product Management & Marketing, since August 2016. Prior to joining Allot, Mr. Priel served as VP Business Management and Strategy, Video Intelligence Solutions (VIS) Division of Verint (NASDAQ: VRNT), a global leader in Actionable Intelligence® solutions with a focus on customer engagement optimization, security intelligence, and fraud, risk and compliance, since 2014. Between 2008 and 2014 Mr. Priel served in a number of executive roles in Verint. Between 2006 and 2008 he served as Senior Director of Products Marketing at Pontis Ltd. and between 1999 and 2004 Mr. Priel served as Product Line Manager & Director of Marketing at ECTel Ltd. Mr. Priel holds a BA in computer science from the Israeli Open University and an M.B.A. from Insead, France.

Rael Kolevsohn joined our company in 2014 and serves as our Vice President—Legal Affairs, General Counsel, and Company Secretary. Prior to joining us, he served as Vice President and General Counsel of Radvision Ltd. from 2007 to 2014. From 1998 to 2007, Mr. Kolevsohn served as General Counsel and Vice President of Gilat Satellite Networks Ltd. after joining Gilat as Legal Counsel. From 1994 to 1998, he completed his legal internship and worked as an Associate at the Tel Aviv law firm of Yossifof, Amir Cohen & Co. Mr. Kolevsohn is a member of the Israel Bar Association and holds an LL.B. degree, with honors, from the Hebrew University in Jerusalem.



Pini Gvili has served as our Vice President—Operations since 2006. Prior to joining us, from 2004 to 2006, he served as Vice President Operations for Celerica, a start-up company specializing in solutions for cellular network optimization. From 2001 to 2004, Mr. Gvili was the Vice President—Operations and IT at Terayon Communication Systems, and from 1998 to 2000, held the position of Manager of Integration and Final Testing at Telegate. Mr. Gvili was also a hardware/software engineer at Comverse/Efrat, a world leader of voice mail and digital recording systems, from 1994 to 1997. Mr. Gvili has a B.Sc. in Computer Science from Champlain University and was awarded a practical electronics degree from ORT Technical College.

Yossi Abraham serves as our Vice President—Business Development since August 2015. Mr. Abraham is responsible for leading global business development initiatives. Prior to joining us, between 2014 and 2015, Mr. Abraham served as Chief Marketing Officer of Excelacom Inc., services and solutions company, providing consulting, professional services and products elements to communications and media providers. Before that, Mr. Abraham held various positions in Comverse Inc., between 2000 and 2014. His last position with Comverse Inc. was Vice President, Global Services Sales and Marketing. Mr. Abraham holds a B.A. in Logistics and Economics from the Bar Ilan University (Cum Laude) and a M.B.A. in marketing from the Tel Aviv University (Magna Cum Laude).

Shaked Levy has served as our Vice President—Customer Success and Growth since February 2016. Prior to joining us Mr. Levy held various managerial positions between 2002 and 2016 at Verint Ltd., a provider of actionable intelligence solutions, most recently as a Senior Vice President – Customer Care & R&D Group, Communications & Cyber Intelligence solutions. Mr. Levy holds an M.B.A. from the Bar Ilan University, a B.A. in Social Sciences, Business Management, from the Open University and a Computers and Electronics Technician diploma, from the Mosinson college.

#### B. Compensation of Officers and Directors

The aggregate compensation paid to or accrued on behalf of our directors and executive officers as a group during 2016 consisted of approximately \$3 million in salary, fees, bonus, commissions and directors' fees, including amounts we expended for automobiles made available to our officers, but excluding equity based compensation, dues for professional and business associations, business travel and other expenses, and other benefits commonly reimbursed or paid by companies in Israel. This amount includes approximately \$0.6 million set aside or accrued to provide pension, severance, retirement or similar benefits or expenses.

In 2016, we paid or accrued to the chairman of the board of directors, Mr. Yigal Jacoby, an annual fee of ILS 146,880 (approximately \$38,200). During such time we also paid and accrued an annual fee of ILS 251,735 (approximately \$65,470) to our former chairman of the board of directors, Mr. Shraga Katz. In addition, we paid our directors, Itzhak Danziger and Rami Hadar ILS 79,440 (approximately \$20,660) and ILS 81,690 (approximately \$21,250), respectively, and we paid or accrued to each of our outside directors, Nurit Benjamini, Steven Levy and Ronnie Keneth, as permitted by the Companies Law, an annual fee of ILS 119,190 (approximately \$31,000), ILS 117,690 (approximately \$30,610) and ILS 123,690 (approximately \$32,170), respectively. The above fees for each of our directors (other than Yigal Jacoby) have included a per meeting attendance fee of ILS 3,750 (approximately \$975) for any meeting he or she attended in person, ILS 2,250 (approximately \$585) for any meeting he or she attended by conference call or similar means, and ILS 1,875 (approximately \$488) for any written resolution of the Board executed by such director. Our directors are also typically granted upon election an agreed amount of equity based awards, which vest over a period of not less than three years, and 10,000 RSUs, as of every third annual general meeting following the respective director's initial election.

In 2016, we paid or accrued to our former President and Chief Executive Officer, Mr. Andrei Elefant, an annual salary of ILS 1,731,662 (approximately \$450,370).

During 2016, our officers and directors received, in the aggregate, options and RSUs to purchase 340,900 ordinary shares under our equity incentive plans. The options (excluding RSUs) have a weighted average exercise price of approximately \$5.34 and expire seven years after the date the options were granted.

## Compensation of our Five Most Highly Compensated Office Holders

## Summary Compensation Table

The table and summary below outline the compensation granted to our five most highly compensated office holders during or with respect to the year ended December 31, 2016. We refer to the five individuals for whom disclosure is provided herein as our “Covered Executives.”

For purposes of the table and the summary below, “compensation” includes base salary, discretionary and non-equity incentive bonuses, equity-based compensation, payments accrued or paid in connection with retirement or termination of employment, and personal benefits and perquisites such as car, phone and social benefits paid to or earned by each Covered Executive during the year ended December 31, 2016.

Name and Principal Position (1)	Salary (\$)	Bonus (\$) (2)	Equity-Based Compensation (\$) (3)	All Other Compensation (\$) (4)	Total (\$)
Andrei Elefant, Former President and Chief Executive Officer	233,963	20,000	625,876	123,904	1,003,743
Gary Drutin, former Chief Customer Officer	242,766		438,496	69,616	750,878
Amir Hochbaum, VP R&D	202,453		191,243	67,312	461,008
Tomas Gomez, Regional VP Sales EMEA South	346,578		50,898		397,476
Shmuel Arvatz, former CFO	217,101		109,985	46,903	373,989

(1) Unless otherwise indicated herein, all Covered Executives are full-time employees of Allot.

(2) Amounts reported in this column represent annual incentive bonuses granted to the Covered Executives based on performance-metric based formulas set forth in their respective employment agreements.

(3) Amounts reported in this column represent the grant date fair value computed in accordance with accounting guidance for stock-based compensation. For a discussion of the assumptions used in reaching this valuation, see Note 12 to our consolidated financial statements for the year ended December 31, 2016, included herein.

(4) Amounts reported in this column include personal benefits and perquisites, including those mandated by applicable law. Such benefits and perquisites may include, to the extent applicable to the respective Covered Executive, payments, contributions and/or allocations for savings funds (e.g., Managers Life Insurance Policy), education funds (referred to in Hebrew as “keren hishtalmut”), pension, severance, vacation, car or car allowance, medical insurances and benefits, risk insurance (e.g., life insurance or work disability insurance), telephone expense reimbursement, convalescence or recreation pay, relocation reimbursement, payments for social security, and other personal benefits and perquisites consistent with the Company’s guidelines. All amounts reported in the table represent incremental cost to the Company.

## Compensation Policy

Under the Companies Law, we are required to adopt a compensation policy, recommended by the compensation and nominating committee and approved by the Board of Directors and the shareholders, in that order. The shareholder approval requires a majority of the votes cast by shareholders, excluding any controlling shareholder and those who have a personal interest in the matter. In general, all directors and executive officers’ terms of compensation, including fixed remuneration, bonuses, equity compensation, retirement or termination payments, indemnification, liability insurance and the grant of an exemption from liability, must comply with the compensation policy.

In addition, the compensation terms of directors, the chief executive officer, and any employee or service provider who is considered a controlling shareholder must be approved separately by the compensation and nominating committee, the Board of Directors and the shareholders of the Company (by the same majority noted above), in that order. The compensation terms of other executive officers require the approval of the compensation and nominating committee and the Board of Directors.

Our compensation policy was approved by our compensation and nominating committee and by our Board of Directors, and subsequently approved by our shareholders in August 2016, and will be in effect for a period of three years following approval. Our compensation policy provides:

**Objectives:** To attract, motivate and retain highly experienced personnel who will provide leadership for Allot's success and enhance shareholder value, and to promote for each executive officer an opportunity to advance in a growing organization.

**Compensation instruments:** Includes base salary; benefits and perquisites; cash bonuses; equity-based awards; and retirement and termination arrangements.

**Ratio between fixed and variable compensation:** Allot aims to balance the mix of fixed compensation (base salary, benefits and perquisites) and variable compensation (cash bonuses and equity-based awards) pursuant to the ranges set forth in the compensation policy in order, among other things, to tie the compensation of each executive officer to Allot's financial and strategic achievements and enhance the alignment between the executive officer's interests and the long-term interests of Allot and its shareholders.

**Internal compensation ratio:** Allot will target a ratio between overall compensation of the executive officers and the average and median salary of the other employees of Allot, as set forth in the compensation policy, to ensure that levels of executive compensation will not have a negative impact on work relations in Allot.

**Base salary, benefits and perquisites:** The compensation policy provides guidelines and criteria for determining base salary, benefits and perquisites for executive officers.

**Cash bonuses:** Allot's policy is to allow annual cash bonuses, which may be awarded to executive officers pursuant to the guidelines and criteria, including maximum bonus opportunities, set forth in the compensation policy.

**"Clawback":** In the event of an accounting restatement, Allot shall be entitled to recover from current executive officers bonus compensation in the amount of the excess over what would have been paid under the accounting restatement, with a three-year look-back.

**Equity-based awards:** Allot's policy is to provide equity-based awards in the form of stock options, restricted stock units and other forms of equity, which may be awarded to executive officers pursuant to the guidelines and criteria, including minimum vesting period, set forth in the compensation policy.

**Retirement and termination:** The compensation policy provides guidelines and criteria for determining retirement and termination arrangements of executive officers, including limitations thereon.

**Exculpation, indemnification and insurance:** The compensation policy provides guidelines and criteria for providing directors and executive officers with exculpation, indemnification and insurance.

**Directors:** The compensation policy provides guidelines for the compensation of our directors in accordance with applicable regulations promulgated under the Companies Law, and for equity-based awards that may be granted to directors pursuant to the guidelines and criteria, including minimum vesting period, set forth in the compensation policy.

**Applicability:** The compensation policy applies to all compensation agreements and arrangements approved after the date on which the compensation policy is approved by the shareholders.

**Review:** The compensation and nominating committee and the Board of Directors of Allot shall review and reassess the adequacy of the Compensation Policy from time to time, as required by the Companies Law.



## C. Board Practices

### Corporate Governance Practices

As a foreign private issuer, we are permitted under NASDAQ Rule 5615(a)(3) to follow Israeli corporate governance practices instead of the NASDAQ Stock Market requirements applicable to the U.S. issuers, provided we disclose which requirements we are not following and describe the equivalent Israeli requirement. See “ITEM 16G: Corporate Governance Requirements” for a discussion of those ways in which our corporate governance practices differ from those required by NASDAQ for domestic companies.

### Board of Directors

#### Terms of Directors

Our articles of association provide that we may have not less than five directors and up to nine directors.

Under our articles of association, our directors (other than the outside directors, whose appointments are required under the Companies Law; see “—Outside Directors”) are divided into three classes. Each class of directors consists, as nearly as possible, of one-third of the total number of directors constituting the entire board of directors (other than the outside directors). At each annual general meeting of our shareholders, the election or re-election of directors following the expiration of the term of office of that class of directors is for a term of office that expires on the third annual general meeting following such election or re-election, such that each year the term of office of only one class of directors will expire.

Our Class II directors, Itzhak Danziger and Miron Kenneth, will hold office until our annual meeting of shareholders to be held in 2017. Our Class III directors, Yigal Jacoby (who also serves as our Chairman of the board of directors) and Rami Hadar, will hold office until our annual meeting of shareholders to be held in 2018. As disclosed in the Notice of Annual General Meeting of Shareholders published by the Company on March 15, 2017, at the 2017 Annual General Meeting, Nadav Zohar will be nominated for election by our shareholders as a Class I director to hold office until the 2019 Annual General Meeting of Shareholders (or, until the 2018 Annual General Meeting of Shareholders, if Proposal 1 on such meeting's agenda relating to the amendment of the Articles of Association of the Company to de-classify the Board, as detailed in the notice of Annual General Meeting of Shareholders, previously published by the Company, is approved). The directors (other than the outside directors) are elected by a vote of the holders of a majority of the voting power present and voting at the meeting. Each director will hold office until the annual general meeting of our shareholders for the year in which his or her term expires and until his or her successor is duly elected and qualified, unless the tenure of such director expires earlier pursuant to the Companies Law or unless he or she resigns or is removed from office.

Under the Companies Law, a director (including an outside director) must declare in writing that he or she has the required skills and the ability to dedicate the time required to serve as a director in addition to other statutory requirements. A director who ceases to meet the statutory requirements for his or her appointment must immediately notify us of the same and his or her office will become vacated upon such notice.

Under our articles of association the approval of a special majority of the holders of at least 75% of the voting rights present and voting at a general meeting is generally required to remove any of our directors (other than the outside directors) from office. The holders of a majority of the voting power present and voting at a meeting may elect directors in their stead or fill any vacancy, however created, in our board of directors. In addition, vacancies on our board of directors, other than a vacancy in the office of an outside director, may be filled by a vote of a simple majority of the directors then in office. A director so chosen or appointed will hold office until the next annual general meeting of our shareholders, unless earlier removed by the vote of a majority of the directors then in office prior to such annual meeting. See “—Outside Directors” for a description of the procedure for election of outside directors.





## Outside Directors

### Qualifications of Outside Directors

The Companies Law requires companies incorporated under the laws of the State of Israel with shares listed on a stock exchange, including the NASDAQ Global Select Market, to appoint at least two outside directors. Our outside directors are Ms. Benjamini and Mr. Levy. Ms. Benjamini also serves as the lead independent director.

Outside directors are required to meet standards of independence and qualifications set forth in the Companies Law and related regulations. Among other independence qualifications, a person may not serve as an outside director if he is a relative of a controlling shareholder of a company, or if he or his affiliate (as defined in the Companies Law) has an employment, business or professional relationship or other affiliation (as defined in the Companies Law) with us.

In addition, the Companies Law requires every outside director appointed to the board of directors of an Israeli company to qualify as a “financial and accounting expert” or as “professionally competent,” as such terms are defined in the applicable regulations under the Companies Law, and at least one outside director must qualify as a “financial and accounting expert.” If at least one of our directors meets the independence requirements of the Exchange Act and the standards of the NASDAQ Stock Market rules for membership on the audit committee and also has financial and accounting expertise as defined in the Companies Law, then the other outside directors are only required to meet the professional qualifications requirement. Under applicable regulations, a director with financial and accounting expertise is a director who, through his or her education, professional experience and skill, has a high level of proficiency in and understanding of business accounting matters and financial statements. He or she must be able to thoroughly comprehend the financial statements of the company and initiate debate regarding the manner in which financial information is presented.

### Election of Outside Directors

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

the majority of shares voted at the meeting, including at least a majority of the shares of non-controlling shareholder(s) and shareholders who do not have a personal interest in the election of the outside director (other than a personal interest that does not result from the shareholder's relationship with a controlling shareholder), voted at the meeting, excluding abstentions, vote in favor of the election of the outside director; or

the total number of shares of non-controlling shareholders and shareholders who do not have a personal interest in the election of the outside director (excluding a personal interest that does not result from the shareholder's relationship with a controlling shareholder) voted against the election of the outside director does not exceed two percent of the aggregate voting rights in the company.

The initial term of an outside director is three years, and he or she may be reelected to up to two additional terms of three years each at a shareholders’ meeting, subject to the voting threshold set forth above. Thereafter, an outside director may be reelected for additional periods of up to three years each, only if the company's audit committee and 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. Outside directors may be removed by the same voting threshold as is required for their election, or by a court, and only if the outside directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. The tenure of outside directors, like all directors, may also be terminated by a court under limited circumstances. If the vacancy of an outside director position causes the company to have fewer than two outside directors, a company’s board of directors is required under the Companies Law to call a special general meeting of the company’s shareholders as soon as possible to appoint a new outside director. Each committee of a company’s board of directors which is authorized to exercise the board of directors’ authorities is required to include at least one outside

director, except for the audit committee and the compensation committee, which are required to include all outside directors.

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An outside director is entitled to compensation and reimbursement of expenses as provided in regulations promulgated under the Companies Law, and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with services provided as an outside director, other than indemnification, exculpation and insurance as permitted pursuant to the Companies Law.

#### NASDAQ Requirements

Under the NASDAQ Stock Market rules, a majority of directors must meet the independence requirements specified in those rules. Our board of directors consists of seven members, six of whom are independent under the NASDAQ Stock Market rules. Specifically, our board has determined that Ms. Nurit Benjamini, Mr. Itzhak Danziger, Mr. Yigal Jacoby, Mr. Steven Levy, Mr. Miron Kenneth and Mr. Nadav Zohar meet the independence standards of the NASDAQ Stock Market rules. In reaching this conclusion, the board determined that none of these directors have a relationship that would preclude a finding of independence and that the other relationships that these directors have with us do not impair their independence. See "ITEM 16G. Corporate Governance" for additional information.

#### Audit Committee

##### Companies Law Requirements

Under the Companies Law, the board of directors of any public company must appoint an audit committee comprised of at least three directors, including all of the outside directors. The following persons may not be appointed as members of the audit committee:

- the chairperson of the board of directors;
- a controlling shareholder or a relative of a controlling shareholder (as defined in the Companies Law); or
- any director who is engaged by, or provides services on a regular basis to the company, the company's controlling shareholder or an entity controlled by a controlling shareholder or any director who generally relies on a controlling shareholder for his or her livelihood.

The Companies Law requires the majority of the audit committee members to be independent directors (as defined in the Companies Law), and the chairman of the audit committee is required to be an outside director. Any person disqualified from serving as a member of the audit committee may not be present at the audit committee meetings, unless the chairperson of the audit committee has determined that this person is required to be present for a particular matter. The Companies Law provides for certain other exclusions to this provision.

#### NASDAQ Requirements

Under the NASDAQ Stock Market rules, companies are required to maintain an audit committee consisting of at least three independent directors, all of whom are financially literate and one of whom has accounting or related financial management expertise. Our audit committee members are required to meet additional independence standards, including minimum standards set forth in rules of the SEC and adopted by the NASDAQ Stock Market.

Each of the members of our audit committee is "independent" under the relevant NASDAQ Stock Market rules and as defined in Rule 10A-3(b)(1) under the Exchange Act, which is different from the general test for independence of board and committee members.

## Approval of Transactions with Related Parties

The approval of the audit committee is required to effect specified actions and transactions with office holders and controlling shareholders. The term “office holder” means a general manager, chief business manager, deputy general manager, vice general manager, or any other person assuming the responsibilities of any of the foregoing positions, without regard to such person’s title, as well as any director or manager directly subordinate to the general manager. The term “controlling shareholder” means a shareholder with the ability to direct the activities of the company, other than by virtue of being an office holder. A shareholder is presumed to be a controlling shareholder if the shareholder holds 50% or more of the voting rights in a company or has the right to appoint the majority of the directors of the company or its general manager. For the purpose of approving transactions with controlling shareholders, the term also includes any shareholder that holds 25% or more of the voting rights of the company, if the company has no shareholder that owns more than 50% of its voting rights. For purposes of determining the holding percentage stated above, two or more shareholders who have a personal interest in a transaction that is brought for the company’s approval are deemed as joint holders. The audit committee may not approve an action or a transaction with a controlling shareholder or with an office holder unless all the requirements of the Companies Law regarding the structure of the committee and the persons entitled to be present at meetings are met at the time of approval.

## Audit Committee Role

Our board of directors has adopted an audit committee charter setting forth the responsibilities of the audit committee consistent with the rules of the SEC and the NASDAQ Stock Market, which include:

- retaining and terminating the company’s independent auditors, subject to shareholder ratification;
- pre-approval of audit and non-audit services provided by the independent auditors; and
- approval of transactions with office holders and controlling shareholders, as described above, and other related-party transactions.

Additionally, under the Companies Law, the audit committee is responsible for: (a) identifying deficiencies in the management of a company’s business and making recommendations to the board of directors as to how to correct them; (b) reviewing and deciding whether to approve certain related party transactions and certain transactions involving conflicts of interest; (c) deciding whether certain actions involving conflicts of interest are material actions and whether certain related party transactions are extraordinary transactions; (d) reviewing the internal auditor’s work program; (e) examining the company’s internal control structure and processes, the performance of the internal auditor and whether the internal auditor has the tools and resources required to perform his or her duties; and (f) examining the independent auditor’s scope of work as well as the independent auditor’s fees, and providing the corporate body responsible for determining the independent auditor’s fees with its recommendations. In addition the audit committee is also responsible for implementing procedures concerning employee complaints on improprieties in the administration of the company’s business and the protection to be provided to such employees. Furthermore, in accordance with regulations promulgated under the Companies Law, the audit committee discusses the draft financial statements and presents to the board its recommendations with respect to the draft financial statements. The audit committee charter states that in fulfilling this role the committee is entitled to rely on interviews and consultations with our management, our internal auditor and our independent auditor, and is not obligated to conduct any independent investigation or verification.

Our audit committee consists of Ms. Nurit Benjamini, Mr. Steven Levy and Mr. Miron Kenneth. The financial experts on the audit committee pursuant to the definition of the SEC are all members of the audit committee.

## Compensation and Nominating Committee

Under the Companies Law, the compensation committee of a public company must consist of at least three directors who satisfy certain independence qualifications, including the additional independence requirements of the NASDAQ Stock Market rules applicable to the members of compensation committees, and the chairman of the compensation committee is required to be an outside director. We have established a compensation and nominating committee which currently consists of Ms. Nurit Benjamini, Mr. Steven Levy, and Mr. Miron Kenneth. The chairperson is Mr. Levy. This committee oversees matters related to our compensation policy and practices. Our board of directors has adopted a compensation and nominating committee charter setting forth the responsibilities of the committee consistent with the Companies Law and the NASDAQ Stock Market rules, which include:

- approving, and recommending to the board of directors and the shareholders for their approval, the compensation of our Chief Executive Officer and other executive officers;
- granting options and RSUs to our employees and the employees of our subsidiaries;
- recommending candidates for nomination as members of our board of directors; and
- developing and recommending to the board corporate governance guidelines and a code of business ethics and conduct in accordance with applicable laws.

The compensation committee is also authorized to retain and terminate compensation consultants, legal counsel or other advisors to the committee and to approve the engagement of any such consultant, counsel or advisor, to the extent it deems necessary or appropriate after specifically analyzing the independence of any such consultant retained by the committee.

On specified criteria, to review modifications to the compensation policy from time to time, to review its implementation and to approve the actual compensation terms of office holders prior to approval by the board of directors.

## Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is, among other things, to examine whether a company's actions comply with applicable law and orderly business procedure. The internal auditor may be an employee of the company but not an interested party (as defined in the Companies Law), an office holder of the company, or a relative of an interested party or an office holder, among other restrictions. The firm of Deloitte Brightman Almagor Zohar is the internal auditor of the Company.

## Exculpation, Insurance and Indemnification of Office Holders

Under the Companies Law, a company may not exculpate an office holder from liability for a breach of the duty of loyalty. However, a company may provide certain indemnification rights as detailed below and obtain insurance for an act performed in breach of the duty of loyalty of an office holder provided that the office holder acted in good faith, the act or its approval does not harm the company, and the office holder discloses the nature of his or her personal interest in the act and all material facts and documents a reasonable time before discussion of the approval. Our articles of association, in accordance with Israeli law, allow us to exculpate an office holder, in advance, from liability to us, in whole or in part, for damages caused to us as a result of a breach of duty of care. We may not exculpate a director for liability arising out of a prohibited dividend or distribution to shareholders or prohibited purchase of its securities.



In accordance with Israeli law, our articles of association allow us to indemnify an office holder in respect of certain liabilities either in advance of an event or following an event. Under Israeli law, an undertaking provided in advance by an Israeli company to indemnify an office holder with respect to a financial liability imposed on him or her in favor of another person pursuant to a judgment, settlement or arbitrator's award approved by a court must be limited to events which in the opinion of the board of directors can be foreseen based on the company's activities when the undertaking to indemnify is given, and to an amount or according to criteria determined by the board of directors as reasonable under the circumstances, and such undertaking must detail the above mentioned events and amount or criteria. Our articles of association allow us to undertake in advance to indemnify an office holder for, among other costs, reasonable litigation expenses, including attorneys' fees, and certain financial liabilities and obligations, subject to certain restrictions pursuant to the Companies Law.

In accordance with Israeli law, our articles of association allow us to insure an office holder against certain liabilities incurred for acts performed as an office holder, including certain breaches of duty of loyalty to the company, a breach of duty of care to the company or to another person and certain financial liabilities and obligations imposed on the office holder.

We may not indemnify or insure an office holder against any of the following:

- a breach of duty of loyalty, except to the extent that the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach of duty of care committed intentionally or recklessly, excluding a breach arising out of the negligent conduct of the office holder;
- an act or omission committed with intent to derive illegal personal benefit; or
- a fine, civil fine, monetary sanction or forfeit levied against the office holder.

Under the Companies Law, exculpation, indemnification and insurance of office holders must be approved by our compensation committee and our board of directors and, in respect of our directors, the chief executive officer, and any employee or service provider who is considered a controlling shareholder, by our shareholders, provided that changes to existing arrangements may be approved by the audit committee if it approves that such changes are immaterial.

As of the date of this annual report, there are no claims for directors' and officers' liability insurance which have been filed in 2016 under our policies and we are not aware of any pending or threatened litigation or proceeding involving any of our directors or officers in which indemnification is sought.

We have entered into agreements with each of our directors and with certain of our office holders exculpating them, to the fullest extent permitted by law, from liability to us for damages caused to us as a result of a breach of duty of care, and undertaking to indemnify them to the fullest extent permitted by law. This indemnification is limited to events determined as foreseeable by the board of directors based on our activities, and to an amount or according to criteria determined by the board of directors as reasonable under the circumstances, and the insurance is subject to our discretion depending on its availability, effectiveness and cost. The current maximum amount set forth in such agreements is the greater of (1) with respect to indemnification in connection with a public offering of our securities, the gross proceeds raised by us and/or any selling shareholder in such public offering, and (2) with respect to all permitted indemnification, including a public offering of our securities, an amount equal to 50% of the our shareholders' equity on a consolidated basis, based on our most recent financial statements made publicly available before the date on which the indemnity payment is made.

In the opinion of the SEC, indemnification of directors and office holders for liabilities arising under the Securities Act is against public policy and therefore unenforceable.



## D. Employees

As of December 31, 2016, we had 440 employees of whom 254 were based in Israel, 95 in Europe, 19 in North America, 19 in Latin America and the remainder in Asia, Africa and Oceania. The breakdown of our employees by department is as follows:

Department	December 31,		
	2014	2015	2016
Manufacturing and operations	18	17	16
Research and development	179	209	163
Sales, marketing, service and support	210	235	216
Management and administration	55	56	45
Total	462	517	440

Under applicable Israeli law, we and our employees are subject to protective labor provisions such as restrictions on working hours, minimum wages, minimum vacation, sick pay, severance pay and advance notice of termination of employment as well as equal opportunity and anti-discrimination laws. Orders issued by the Israeli Ministry of Economy make certain industry-wide collective bargaining agreements applicable to us. These agreements affect matters such as cost of living adjustments to salaries, length of working hours and week, recuperation, travel expenses, and pension rights. Our employees are not represented by a labor union. We provide our employees with benefits and working conditions which we believe are competitive with benefits and working conditions provided by similar companies in Israel. We have never experienced labor-related work stoppages and believe that our relations with our employees are good.

## E. Share Ownership

## Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information regarding the beneficial ownership of our ordinary shares as of March 1, 2017 by (i) each of our directors, (ii) each of our executive officers and (iii) all of our executive officers and directors serving as of March 1, 2017, as a group. Unless otherwise stated, the address of each named executive officer and director is c/o Allot Communications Ltd., 22 Hanagar Street, Neve Ne'eman Industrial Zone B, Hod-Hasharon 4501317, Israel.

Name of Beneficial Owner	Number of Shares Beneficially Held(1)	Percent of Class
Directors		
Nurit Benjamini	*	*
Itzhak Danziger	*	*
Rami Hadar	*	*
Nadav Zohar	*	*
Steven D. Levy	*	*
Yigal Jacoby	*	*
Miron Kenneth	*	*
Executive Officers		
Erez Antebi	*	*
Alberto Sessa	*	*
Amir Hochbaum	*	*

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Anat Shenig	*	*	
Ronen Priel	*	*	
Rael Kolevsohn	*	*	
Pini Gvili	*	*	
Shaked Levy	*	*	
Yossi Avraham	*	*	
All directors and executive officers as a group	359,310	1.08	%

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\*Less than one percent of the outstanding ordinary shares.

As used in this table, “beneficial ownership” is determined in accordance with the rules of the SEC and consists of either or both voting or investment power with respect to securities. For purposes of this table, a person is deemed to be the beneficial owner of securities that can be acquired within 60 days from March 1, 2017 through the exercise of any option or pursuant to vesting of RSU. Ordinary shares subject to options that are currently exercisable or exercisable within 60 days of March 1, 2017 and outstanding RSUs vesting within 60 days of (1) March 1, 2017, are deemed outstanding for computing the ownership percentage of the person holding such options or RSUs, but are not deemed outstanding for the purpose of computing the ownership percentage of any other person. Except as otherwise indicated, the persons named in the table have reported that they have sole voting and sole investment power with respect to all shares of common stock shown as beneficially owned by them. The amounts and percentages are based upon 33,114,380 ordinary shares outstanding as of March 1, 2017 pursuant to Rule 13d-3(d)(1)(i) under the Exchange Act.

Our directors and executive officers hold, in the aggregate, 932,009 outstanding options and RSUs. The said amount includes options currently exercisable for 345,350 ordinary shares, as of March 1, 2017. The options (excluding RSUs) have a weighted average exercise price of \$7.92 per share and have expiration dates until 2024.

### Share Option Plans

The following table summarizes our equity incentive plans, which have outstanding awards as of March 1, 2017:

Plan	Share reserved	Option and RSU grants, net (*)	Outstanding options and RSUs	Options outstanding exercise price	Date of expiration	Options exercisable
2016 incentive compensation plan	691,564	6,232,338	2,859,868	0.028-27.58	1/3/2017-6/11/2022	1,122,195
2003 incentive compensation plan	-	2,987,330	-	-	-	-
1997 incentive compensation plan	-	766,071	-	-	-	-

(\*) “Option and RSU grants, net” is calculated by subtracting options and RSUs expired or forfeited.

As of March 1, 2017 we had 33,114,380 ordinary shares outstanding. We have adopted three share option plans. Under our share option plans, as of March 1, 2017, there were 2,859,868 outstanding options and RSUs. The said amount includes options currently exercisable for 1,122,195 ordinary shares. As of March 1, 2017, 691,564 shares remained available for future grants under the 2016 Plan (as described below) Upon issuance, such ordinary shares may be freely sold in the public market, except for shares held by affiliates who have certain restrictions on their ability to sell. The options (excluding RSUs) have a weighted average exercise price of \$8.06 per share.

We will only grant options, RSUs or other equity incentive awards under the 2016 Incentive Compensation Plan, although previously-granted options will continue to be governed by our other plans.

2016 Incentive Compensation Plan, as amended (formerly, 2006 Incentive Compensation Plan)

The Allot Communications Ltd. 2006 Incentive Compensation Plan (the “2006 Plan”) was adopted by the Board on October 29, 2006 and became effective immediately prior to the effective date of the Company’s IPO. Effective October 28, 2016, the Board of Directors of the Company amended and restated the 2006 Plan to extend the term of the 2006 Plan by ten years and to rename the 2006 Plan as the Allot Communications Ltd. 2016 Incentive Compensation Plan (the “2016 Plan”). The 2016 Plan will remain in effect, subject to the right of the Board of Directors to amend or terminate the 2016 Plan at any time pursuant to the terms of the 2016 Plan, until all shares reserved for issuance under the 2016 Plan shall have been delivered, and any restrictions on such shares shall have lapsed, provided that in no event may an award under the 2016 Plan be granted on or after October 27, 2026.

The 2016 Plan is intended to further our success by increasing the ownership interest of certain of our and our subsidiaries’ employees, directors and consultants and to enhance our and our subsidiaries’ ability to attract and retain employees, directors and consultants.

The number of ordinary shares that we may issue under the 2016 Plan will increase on the first day of each fiscal year during the term of the 2016 Plan, in each case in an amount equal to the lesser of (i) 1,000,000 shares, (ii) 3.5% of our outstanding ordinary shares on the last day of the immediately preceding year, or (iii) an amount determined by our board of directors. The number of shares subject to the 2016 Plan is also subject to adjustment if particular capital changes affect our share capital. Ordinary shares subject to outstanding awards under the 2016 Plan or our 2003 plan or 1997 plans that are subsequently forfeited or terminated for any other reason before being exercised will again be available for grant under the 2016 Plan. As of March 1, 2017, there were 2,859,868 outstanding options and RSUs under the 2016 Plan and 691,564 ordinary shares remained reserved for future grants under the 2016 Plan.

Israeli participants in the 2016 Plan may be granted options and/or restricted stock units subject to Section 102 of the Ordinance. Section 102 of the Ordinance, allows employees, directors and officers, who are not controlling shareholders and are considered Israeli residents to receive favorable tax treatment for compensation in the form of shares or options. Our non-employees service providers and controlling shareholders may only be granted options under another section of the Ordinance, which does not provide for similar tax benefits. Section 102 includes two alternatives for tax treatment involving the issuance of options or shares to a trustee for the benefit of the grantees and also includes an additional alternative for the issuance of options or shares directly to the grantee. The most favorable tax treatment for the grantees is under Section 102(b)(2) of the Ordinance, the issuance to a trustee under the “capital gain track.” However, under this track we are not allowed to deduct an expense with respect to the issuance of the options or shares. Any stock options granted under the 2016 Plan to participants in the United States will be either “incentive stock options,” which may be eligible for special tax treatment under the U.S. Internal Revenue Code of 1986, or options other than incentive stock options (referred to as “nonqualified stock options”), as determined by our compensation and nominating committee and stated in the option agreement.

Our compensation and nominating committee administers the 2016 Plan and it selects which of our and our subsidiaries’ and affiliates’ eligible employees, directors and/or consultants receive options, RSUs or other awards under the 2016 Plan and will determine the terms of the grant, including, exercise prices, method of payment, vesting schedules, acceleration of vesting and the other matters necessary in the administration of the plan.

If we undergo a change of control, as defined in the 2016 Plan, subject to any contrary law or rule, or the terms of any award agreement in effect before the change of control, (a) the compensation and nominating committee may, in its discretion, accelerate the vesting, exercisability and payment, as applicable, of outstanding options, RSUs and other awards; and (b) the compensation and nominating committee, in its discretion, may adjust outstanding awards by substituting ordinary shares or other securities of any successor or another party to the change of control transaction, or cash out outstanding options, RSUs and other awards, in any such case, generally based on the consideration received by our shareholders in the transaction.



## ITEM 7: Major Shareholders and Related Party Transactions

## A. Major Shareholders

The following table sets forth certain information regarding the beneficial ownership of our outstanding ordinary shares as of March 1, 2017, by each person who we know beneficially owns 5.0% or more of the outstanding ordinary shares. Each of our shareholders has identical voting rights with respect to its shares. All of the information with respect to beneficial ownership of the ordinary shares is given to the best of our knowledge.

	Ordinary Shares Beneficially Owned(1)	Percentage of Ordinary Shares Beneficially Owned	
Zohar Zisapel (2)	2,842,378	8.6	%
Migdal Insurance & Financial holdings Ltd (3)	2,391,117	7.2	%
FMR LLC and Abigail P. Johnson (4)	3,227,461	9.7	%
Clal Insurance Enterprises Holdings Ltd. (5)	2,437,644	7.4	%
Soros Fund Management LLC (6)	3,336,166	10.1	%

As used in this table, “beneficial ownership” means the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security. For purposes of this table, a person is deemed to be the beneficial owner of securities that can be acquired within 60 days from March 1, 2017 through the exercise of any option or (1) warrant. Ordinary shares subject to options or warrants that are currently exercisable or exercisable within 60 days are deemed outstanding for computing the ownership percentage of the person holding such options or warrants, but are not deemed outstanding for computing the ownership percentage of any other person. The amounts and percentages are based upon 33,114,380 ordinary shares outstanding as of March 1, 2017.

Based on a Schedule 13G/A filed on January 13, 2011. Consists of 2,777,487 shares held by Zohar Zisapel and (2) 64,891 shares held by Lomsha Ltd., an Israeli company controlled by Zohar Zisapel. The address of Mr. Zisapel and Lomsha Ltd. is 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel.

Based on a Schedule 13G filed on January 26, 2017, Migdal Insurance & Financial Holdings Ltd reported that it had shared voting power and dispositive power over these shares. Of these shares, 2,391,117 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 & Financial Holdings Ltd, according to the (3) following segmentation: 1,222,490 shares are held by Profit participating life assurance accounts; 947,042 shares are held by Provident funds and companies that manage provident funds and 200,577 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. In addition, 21,008, shares are beneficially held for their own account (Nostro account). The address of the reporting person is 4 Efal Street; P.O BOX 3063; Petach Tikva 49512, Israel.

Based on a Schedule 13G filed on February 14, 2017. FMR LLC reported that it had sole voting power over (4) 1,885,000 shares and sole dispositive power over 3,227,461 shares and Abigail P. Johnson, director, vice-chairman and chief executive officer of FMR LLC had sole dispositive power over 3,227,461 shares. The address of the reporting person is 245 Summer Street, Boston, Massachusetts 02210.

Based on information provided to us by Clal Insurance Enterprises Holdings Ltd. (“Clal”) on March 1, 2017 Clal (5) had shared voting and dispositive power over 2,437,644 of our shares as of such date. The address of the reporting person is 36 Raoul Wallenberg Street, Tel Aviv 37070, Israel.

Based on a Schedule 13G filed on February 2, 2017, each of Soros Fund Management LLC, George Soros and (6) Robert Soros reported that they held sole voting and dispositive power over 3,336,166 shares. The address for the reporting persons is 250 West 55<sup>th</sup> Street, 38<sup>th</sup> Floor, New York, New York 10019.

### Significant Changes in the Ownership of Major Shareholders

As of March 1, 2017, Zohar Zisapel was the beneficial owner of 2,842,378, or 8.6%, of our ordinary shares. His beneficial ownership did not change since December 31, 2010.

As of March 1, 2017, Migdal Insurance & Financial Holdings Ltd was the beneficial owner 2,391,117 shares, or 7.2% of our ordinary shares. As of March 1, 2016, Migdal Insurance & Financial Holdings Ltd was the beneficial owner of 2,573,259, or 7.7%, of our ordinary shares. As of March 1, 2015, Migdal Insurance & Financial Holdings Ltd was the beneficial owner of 2,484,436, or 7.4%, of our ordinary shares.

As of March 1, 2017, FMR LLC was the beneficial owner of 3,227,461, or 9.7% of our ordinary shares. As of March 1, 2016, FMR LLC was the beneficial owner of 2,742,676, or 8.2% of our ordinary shares. As of March 1, 2015, FMR LLC was the beneficial owner of 3,250,691, or 9.9%, of our ordinary shares.

As of March 1, 2017, T. Rowe Price Associates, Inc. ceased to be the beneficial owner of 5% or more of our ordinary shares. As of March 1, 2016, T. Rowe Price Associates, Inc. was the beneficial owner of 1,866,840, or 5.5%, of our ordinary shares. As of March 1, 2015, T. Rowe Price Associates, Inc. was the beneficial owner of 1,531,880, or 4.6%, of our ordinary shares.

As of March 1, 2017, Alyeska Investment Group, L.P. ceased to be the beneficial owner of 5% or more of our ordinary shares. As of March 1, 2016, Alyeska Investment Group, L.P. was the beneficial owner of 1,842,720, or 5.5%, of our ordinary shares.

As of March 1, 2017, Soros Fund Management LLC was the beneficial owner of 3,336,166, or 10.1% of our ordinary shares.

As of March 1, 2017, Clal Insurance Enterprises Holdings Ltd. was the beneficial owner of 2,437,644, or 7.4% of our ordinary shares

### Record Holders

As of March 1, 2017, there were 17 record holders of ordinary shares, of which eight consisted of United States record holders holding approximately 99.47% of our outstanding ordinary shares. The actual number of shareholders is greater than this number of record holders, and includes shareholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees. The United States record holders included Cede & Co., the nominee of the Depository Trust Company.

### B. Related Party Transactions

Our policy is to enter into transactions with related parties on terms that, on the whole, are no less favorable, than those available from unaffiliated third parties. Based on our experience in the business sectors in which we operate and the terms of our transactions with unaffiliated third parties, we believe that all of the transactions described below met this policy standard at the time they occurred.



## Agreements with Directors and Officers

**Engagement of Officers.** We have entered into employment agreements with each of our officers, who work for us as employees or as consultants. These agreements all contain provisions standard for a company in our industry regarding noncompetition, confidentiality of information and assignment of inventions. The enforceability of covenants not to compete in Israel may be limited. In connection with the engagement of our officers, we have granted them options pursuant to our 2016 Plan.

**Exculpation, Indemnification and Insurance.** Our articles of association permit us to exculpate, indemnify and insure our office holders, in accordance with the provisions of the Companies Law. We have entered into agreements with each of our directors and certain office holders, exculpating them from a breach of their duty of care to us to the fullest extent permitted by law and undertaking to indemnify them to the fullest extent permitted by law, to the extent that these liabilities are not covered by insurance. See “ITEM 6: Directors, Senior Management and Employees—Board Practices—Exculpation, Insurance and Indemnification of Office Holders.”

## Agreement with Galil Software

Our director, Itzhak Danziger, is a member of the board of directors of Galil Software Ltd and holds less than 10% of its shares. We have engaged Galil Software since 2010 to provide us with certain quality assurance services in the ordinary course of our business. Since January 1, 2016 and through the date of the filing of this annual report, we did not pay any fees to Galil Software.

## C. Interests of Experts and Counsel

Not applicable.

## ITEM 8: Financial Information

### A. Consolidated Financial Statements and Other Financial Information.

#### Consolidated Financial Statements

For our audited consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016, please see pages F-3 to F-46 of this report.

#### Export Sales

See “ITEM 5: Operating and Financial Review and Prospects” under the caption “Geographic Breakdown of Revenues” for certain details of export sales for the last three fiscal years.

#### Legal Proceedings

We may, from time to time in the future be involved in legal proceedings in the ordinary course of business.

#### Dividends

We have never declared or paid any cash dividends on our ordinary shares and we do not anticipate paying any cash dividends on our ordinary shares in the future. We currently intend to retain all future earnings to finance our operations and to expand our business. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including future earnings, capital

requirements, financial condition and future prospects and other factors our board of directors may deem relevant.

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## B. Significant Changes

Since the date of our audited financial statements included elsewhere in this annual report, there have not been any significant changes in our financial position

## ITEM 9: The Offer and Listing

Not applicable, except for Items 9.A.4 and 9.C, which are detailed below.

## Stock Price History

Our ordinary shares have been trading on the NASDAQ Global Select Market under the symbol “ALLT” since November 2006. The following table sets forth the high and low sales prices for our ordinary shares as reported by each of the NASDAQ Global Select Market, in U.S. dollars, and the Tel Aviv Stock Exchange (since December 2012), in ILS, for the periods indicated below:

Year	NASDAQ Global Select Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2012	\$ 28.03	\$ 15.55	NIS 111.60	NIS 58.56
2013	18.28	11.01	68.12	39.20
2014	18.09	7.88	63.99	31.13
2015	9.85	4.41	39.9	18.21
2016	5.89	4.24	23.50	16.84
2017 (through March 1, 2017)	5.67	4.75	21.53	17.58

	NASDAQ Global Select Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2015				
First Quarter	\$ 9.85	\$ 8.71	NIS 39.9	NIS 33.62
Second Quarter	9.41	6.92	36.9	26.36
Third Quarter	7.34	4.41	27.83	18.21
Fourth Quarter	6.23	4.82	24.21	18.83

	NASDAQ Global Select Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2016				
First Quarter	\$ 5.89	\$ 4.24	NIS 23.50	NIS 16.84
Second Quarter	5.65	4.53	20.50	17.56
Third Quarter	5.63	4.52	21.75	17.33
Fourth Quarter	5.66	4.50	20.80	17.67

Most Recent Six Months	NASDAQ Global Select Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
March 2017 (through March 1, 2017)	\$ 4.94	\$ 4.86	NIS 18.22	NIS 17.58
February 2017	5.36	4.78	20.00	17.90
January 2017	5.67	4.75	21.53	18.00
December 2016	5.09	4.50	18.98	17.79
November 2016	5.14	4.58	20.29	17.67
October 2016	5.66	5.14	20.80	19.97
September 2016	5.50	5.00	20.71	19.00



## Markets

Our ordinary shares have been quoted under the symbol “ALLT” on the NASDAQ Stock Market since November 16, 2006 and on the Tel Aviv Stock Exchange since December 21, 2010.

As of March 1, 2017, the last reported sale price of our ordinary shares on the Nasdaq Global Select Market was 4.92 per share and on the Tel Aviv Stock Exchange was 18.01 per share.

## ITEM 10: Additional Information

### A. Share Capital

Not applicable.

### B. Memorandum and Articles of Association

#### Memorandum and Articles of Association Incorporation

We are registered as a public company with the Israeli Registrar of Companies. Our registration number is 51-239477-6.

#### Objective

Our objectives under our memorandum of association are to engage in the business of computers, hardware and software, including without limitation research and development, marketing, consulting and the selling of knowledge, and any other activity which our board of directors shall determine.

#### Ordinary Shares

Our authorized share capital consists of 200,000,000 ordinary shares, par value ILS 0.10 per share. As of March 1, 2017, we had 33,114,380 ordinary shares outstanding. All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the Ordinary Shares are as follows:

**Voting.** Holders of our ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders at a shareholder meeting. Shareholders may vote at shareholder meeting either in person, by proxy or by written ballot. Shareholder voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

**Transfer of Shares.** Fully paid ordinary shares are issued in registered form and may be freely transferred under our articles of association unless the transfer is restricted or prohibited by another instrument, Israeli law or the rules of a stock exchange on which the shares are traded.

**Election of Directors.** Our ordinary shares do not have cumulative voting rights for the election of directors. Rather, under our articles of association our directors are elected by the holders of a simple majority of our ordinary shares at a general shareholder meeting. As a result, the holders of our ordinary shares that represent more than 50% of the voting power represented at a shareholder meeting have the power to elect any or all of our directors whose positions are being filled at that meeting, subject to the special approval requirements for outside directors. See “ITEM 6: Directors, Senior Management and Employees—Board Practices—Outside Directors.”

**Dividend and Liquidation Rights.** Under the Companies Law, shareholder approval is not required for the declaration of a dividend, unless the company’s articles of association provide otherwise. Our articles of association provide that

our board of directors may declare and distribute a dividend to be paid to the holders of ordinary shares without shareholder approval in proportion to the paid up capital attributable to the shares that they hold. Dividends may be paid only out of profits legally available for distribution, as defined in the Companies Law, provided that there is no reasonable concern that the payment of a dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. If we do not have profits legally available for distribution, we may seek the approval of the court to distribute a dividend. The court may approve our request if it is convinced that there is no reasonable concern that a payment of a dividend will prevent us from satisfying our existing and foreseeable obligations as they become due.

In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the paid up capital attributable to the shares that they hold. Dividend and liquidation rights may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

### Shareholder Meetings

We are required to convene an annual general meeting of our shareholders once every calendar year within a period of not more than 15 months following the preceding annual general meeting. Our board of directors may convene a special general meeting of our shareholders and is required to do so at the request of two directors or one quarter of the members of our board of directors or at the request of one or more holders of 5% or more of our share capital and 1% of our voting power or the holder or holders of 5% or more of our voting power. All shareholder meetings require prior notice of at least 21 days. The chairperson of our board of directors, or any other person appointed by the board of directors, presides over our general meetings. In the absence of the chairperson of the board of directors or such other person, one of the members of the board designated by a majority of the directors presides over the meeting. If no director is designated to preside as chairperson, then the shareholders present will choose one of the shareholders present to be chairperson. Subject to the provisions of the Companies Law and the regulations promulgated thereunder, shareholders entitled to participate and vote at general meetings are the shareholders of record on a date to be decided by the board of directors, which may be between four and 40 days prior to the date of the meeting.

### Quorum

The quorum required for a meeting of shareholders consists of at least two shareholders present in person, by proxy or by written ballot, who hold or represent between them at least 25% of our voting power. 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 directors designate in a notice to the shareholders. At the reconvened meeting, the required quorum consists of at least two shareholders present, in person, by proxy or by written ballot, who hold or represent between them at least 10% of our voting power, provided that if the meeting was initially called pursuant to a request by our shareholders, then the quorum required must include at least the number of shareholders entitled to call the meeting. See “— Shareholder Meetings.”

### Resolutions

An ordinary resolution requires approval by the holders of a simple majority of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting on the resolution.

Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority. A resolution for the voluntary winding up of the company requires the approval by holders of at least 75% of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting on the resolution. Under our articles of association (1) certain shareholders' resolutions require the approval of a special majority of the holders of at least 75% of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting on the resolution, and (2) certain shareholders' resolutions require the approval of a special majority of the holders of at least two-thirds of the voting securities of the company then outstanding.

## Access to Corporate Records

Under the Companies Law, all shareholders generally have the right to review minutes of our general meetings, our shareholder register, including with respect to material shareholders, our articles of association, our financial statements and any document we are required by law to file publicly with the Israeli Companies Registrar. Any shareholder who specifies the purpose of its request may request to review any document in our possession that relates to any action or transaction with a related party which requires shareholder approval under the Companies Law. We may deny a request to review a document if we determine that the request was not made in good faith, that the document contains a commercial secret or a patent or that the document's disclosure may otherwise impair our interests.

## Fiduciary duties and approval of specified related party transactions under Israeli law

### Fiduciary duties of office holders

The Companies Law imposes a duty of care and a duty of loyalty on all office holders of a company.

The duty of care of an office holder requires an office holder to act with the degree of proficiency with which a reasonable office holder in the same position would have acted under the same circumstances. The duty of care includes, among other things, a duty to use reasonable means, in light of the circumstances, to obtain certain information pertaining to the proposed action before the board of directors.

The duty of loyalty incumbent on an office holder requires him or her to act in good faith and for the benefit of the company, and includes, among other things, the duty to avoid conflicts of interest with the company, to refrain from competing with the company, and to disclose to the company information disclosed to him or her as a result of being an office holder.

We may approve an act specified above which would otherwise constitute a breach of the office holder's duty of loyalty, provided that the office holder acted in good faith, the act or its approval does not harm the company, and the office holder discloses his or her personal interest a sufficient time before the approval of such act. Any such approval is subject to the terms of the Companies Law, setting forth, among other things, the organs of the company entitled to provide such approval, and the methods of obtaining such approval.

### Disclosure of personal interests of an office holder and approval of acts and transactions

The Companies Law requires that an office holder promptly disclose to the company any personal interest that he or she may have relating to any existing or proposed transaction by the company (as well as certain information or documents). Once an office holder has disclosed his or her personal interest in a transaction, the approval of the appropriate organ(s) in the company is required in order to effect the transaction. However, a company may approve such a transaction or action only if it is in the best interests of the Company.

### Disclosure of personal interests of a controlling shareholder and approval of transactions

Under the Companies Law, a controlling shareholder must also disclose any personal interest it may have in an existing or proposed transaction by the company. Transactions with controlling shareholders that are material, that are not in the ordinary course of business or that are not on market terms require approval by the audit committee, the board of directors and the shareholders of the company, and the Companies Law provides for certain quantitative requirements in respect of the voting of shareholders not having a personal interest in the applicable transaction.



## Duties of shareholders

Under the Companies Law, a shareholder has a duty to refrain from abusing its power, to act in good faith and to act in an acceptable manner in exercising its rights and performing its obligations to the company and other shareholders. A shareholder also has a general duty to refrain from acting to the detriment of other shareholders.

In addition, any controlling shareholder or any shareholder having specific power with respect to a company (the power to appoint an office holder, or specific influence over a certain vote) is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty except to state that the remedies generally available upon a breach of contract will also apply in the event of a breach of the duty to act with fairness, taking the shareholder's position in the company into account.

## Approval of private placements

Under the Companies Law and the regulations promulgated thereunder, certain private placements of securities may require approval at a general meeting of the shareholders of a company. These include, for example, certain private placements completed in lieu of a special tender offer (See "Memorandum and Articles of Association—Acquisition under Israeli law") or a private placement which qualifies as a related party transaction (See "Corporate governance practices—Fiduciary duties and approval of specified related party transactions under Israeli law").

## Acquisitions under Israeli Law

**Full Tender Offer.** A person wishing to acquire shares of a public Israeli company and who would as a result hold over 90% of the target company's issued and outstanding share capital is required by the Companies Law to make a tender offer for the purchase of all of the issued and outstanding shares of the company. If the shareholders who do not accept the offer hold less than 5% of the issued and outstanding share capital of the company, and more than half of the offerees who do not have a personal interest in the tender offer accept the tender offer, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. Notwithstanding the above, if the shareholders who do not accept the offer hold less than 2% of the issued and outstanding share capital of the company or of the applicable class, the offer will nonetheless be accepted. However, a shareholder that had its shares so transferred may, within six months from the date of acceptance of the tender offer, petition the court to determine that the tender offer was for less than fair value and that the fair value should be paid as determined by the court. The bidder may provide in its tender offer that any accepting shareholder may not petition the court for fair value, but such condition will not be valid unless all of the information required under the Companies Law was provided prior to the acceptance date. The description above regarding a full tender offer also applies, with certain limitations, when a full tender offer for the purchase of all of the company's securities is accepted.

**Special Tender Offer.** The Companies Law provides, subject to certain exceptions, that an acquisition of shares of a public Israeli company must be made by means of a "special tender offer" if, as a result of the acquisition, the purchaser would become a holder of at least 25% of the voting rights in the company. This rule does not apply if there is already another holder of at least 25% of the voting rights in the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would become a holder of more than 45% of the voting rights in the company, and there is no other shareholder of the company who holds more than 45% of the voting rights in the company. The special tender offer may be consummated subject to certain majority requirements set forth in the Companies Law, and provided further that at least 5% of the voting rights attached to the company's outstanding shares will be acquired by the party making the offer.

**Merger.** The Companies Law permits merger transactions between two Israeli companies if approved by each party's board of directors and a certain percentage of each party's shareholders. Following the approval of the board of directors of each of the merging companies, the boards must jointly prepare a merger proposal for submission to the

Israeli Registrar of Companies.

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Under the Companies Law, if the approval of a general meeting of the shareholders is required, merger transactions may be approved by the holders of a simple majority of our shares present, in person, by proxy or by written ballot, at a general meeting of the shareholders and voting on the transaction. In determining whether the required majority has approved the merger, if shares of the company are held by the other party to the merger, by any person holding at least 25% of the voting rights, or 25% of the means of appointing directors or the general manager of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party or by such person, or any person or entity acting on behalf of, related to or controlled by either of them, is sufficient to reject the merger transaction. In certain circumstances, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders.

The Companies Law provides for certain requirements and procedures that each of the merging companies is to fulfill. In addition, a merger may not be completed unless at least fifty days have passed from the date that a proposal for approval of the merger was filed with the Israeli Registrar of Companies and thirty days from the date that shareholder approval of both merging companies was obtained.

#### Anti-Takeover Measures

Undesignated preferred shares. The Companies Law allows us to create and issue shares having rights different from those attached to our ordinary shares, including shares providing certain preferred or additional rights with respect to voting, distributions or other matters and shares having preemptive rights. We do not have any authorized or issued shares other than ordinary shares. In the future, if we do create and issue a class of shares other than ordinary shares, such class of shares, depending on the specific rights that may be attached to them, may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares will require an amendment to our articles of association which requires the prior approval of a simple majority of our shares represented and voted at a general meeting. In addition, we undertook towards the TASE that, as long as our shares are registered for trading with the TASE we will not issue or authorize shares of any class other than the class currently registered with the TASE, unless such issuance is in accordance with certain provisions of the Israeli Securities Law determining that a company registering its shares for trade on the TASE may not have more than one class of shares for a period of one year following registration with the TASE, and following such period the company is permitted to issue preferred shares if the preference of those shares is limited to a preference in the distribution of dividends and the preferred shares have no voting rights.

Supermajority voting. Our articles of association require the approval of the holders of at least two-thirds of our combined voting power to effect certain amendments to our articles of association.

Classified board of directors. Our articles of association provide for a classified board of directors. See “ITEM 6: Directors, Senior Management and Employees—Board Practices—Term of Directors.”

#### Transfer Agent and Registrar

The transfer agent and registrar for our ordinary shares is American Stock Transfer & Trust Company. Its address is 6201 15th Avenue, Brooklyn, New York 11219, and its telephone number is (800) 937-5449.

### C. Material Contracts

We have not been party to any material contracts within the two years prior to the date of this annual report, other than contracts entered into in the ordinary course of business, or as otherwise described below in this ITEM 10.C.

Material Contract	Location
Agreement with Flex (Israel) Ltd. and Amendment No. 1 thereto	“ITEM 4.B: Information on the Company–Business Overview–Manufacturing.”
Agreement with Optenet S.A	“ITEM 5.A: Operating and Financial Review and Prospects-Operating Results”
Non-Stabilized Lease Agreement	“ITEM 4: Information on Allot – D. Property, Plant and Equipment”

### D. Exchange Controls

In 1998, Israeli currency control regulations were liberalized significantly, so that Israeli residents generally may freely deal in foreign currency and foreign assets, and non-residents may freely deal in Israeli currency and Israeli assets. There are currently no Israeli currency control restrictions on remittances of dividends on the ordinary shares or the proceeds from the sale of the shares provided that all taxes were paid or withheld; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time.

Non-residents of Israel may freely hold and trade our securities. Neither our memorandum of association nor our articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of ordinary shares by non-residents, except that such restrictions may exist with respect to citizens of countries which are in a state of war with Israel. Israeli residents are allowed to purchase our ordinary shares.

### E. Taxation

#### Israeli Tax Considerations and Government Programs

The following is a general discussion only and is not exhaustive of all possible tax considerations. It is not intended, and should not be construed, as legal or professional tax advice and should not be relied upon for tax planning purposes. In addition, this discussion does not address all of the tax consequences that may be relevant to purchasers of our ordinary shares in light of their particular circumstances, or certain types of purchasers of our ordinary shares subject to special tax treatment. Examples of this kind of investor include residents of Israel and traders in securities who are subject to special tax regimes not covered in this discussion. Each individual/entity should consult its own tax or legal advisor as to the Israeli tax consequences of the purchase, ownership and disposition of our ordinary shares.

To the extent that part of the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure that the tax authorities or the courts will accept the views expressed in this section.

The following summary describes the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to holders of our ordinary shares.

#### General Corporate Tax Structure in Israel

Israeli companies are generally subject to corporate tax. In 2016 and 2015, the corporate tax rate was 25% and 26.5%, respectively. The corporate tax rate for 2017 is scheduled to be 24% and the corporate tax rate for 2018 and thereafter is scheduled to be 23%. However, the effective tax rate payable by a company that derives income from an Approved

Enterprise, a Benefited Enterprise or a Preferred Enterprise (as discussed below) may be considerably less. Capital gains derived by an Israeli company are generally subject to the prevailing corporate tax rate.

## Tax Benefits and Grants for Research and Development

Israeli tax law allows, under certain conditions, a tax deduction for expenditures, including capital expenditures, for the year in which they are incurred. Expenditures are deemed related to scientific research and development projects, if:

- The expenditures are approved by the relevant Israeli government ministry, determined by the field of research;
- The research and development must be for the promotion of the company; and
- The research and development is carried out by or on behalf of the company seeking such tax deduction.

The amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. No deduction under these research and development deduction rules is allowed if such deduction is related to an expense invested in an asset depreciable under the general depreciation rules of the Ordinance. Expenditures from research and development that not so approved are deductible in equal amounts over three years, according to the Ordinance.

From time to time we may apply the Israel Innovation Authority for approval to allow a tax deduction for all research and development expenses during the year incurred. There can be no assurance that such application will be accepted.

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

The Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, provides several tax benefits for industrial companies. We believe that we currently qualify as an “Industrial Company” within the meaning of the Industry Encouragement Law. The Industry Encouragement Law defines “Industrial Company” as a company resident in Israel, of which 90% or more of its income in any tax year, other than of income from defense loans, capital gains, interest and dividend, is derived from an “Industrial Enterprise which is located in Israel” owned by it. An “Industrial Enterprise” is defined as an enterprise whose major activity in a given tax year is industrial production activity.

The following corporate tax benefits, among others, are available to Industrial Companies:

· Amortization of the cost of purchased know-how and patents and of rights to use a patent and know-how which are used for the development or advancement of the company, over an eight-year period;

· Under specified conditions, an election to file consolidated tax returns with additional related Israeli Industrial Companies; and

· Expenses related to a public offering in Israel and in recognized stock markets, are deductible in equal amounts over three years.

Under certain tax laws and regulations, an “Industrial Enterprise” may be eligible for special depreciation rates for machinery, equipment and buildings. These rates differ based on various factors, including the date the operations begin and the number of work shifts. An “Industrial Company” owning an approved enterprise may choose between these special depreciation rates and the depreciation rates available to the approved enterprise.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. We can give no assurance that we qualify or 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, the Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Ordinance, came into effect (the “TP Regulations”). Section 85A of the Ordinance and the TP Regulations generally require that all cross-border transactions carried out between related parties be conducted on an arm’s length basis and be taxed accordingly. The TP Regulations did not have a material effect on us.

## Tax Benefits under the Law for Encouragement of Capital Investments, 1959

### Tax Benefits Prior to the 2005 Amendment

The Law for the Encouragement of Capital Investments, 1959, as amended (effective as of April 1, 2005), generally referred to as the Investments Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an “Approved Enterprise.” The Investment Center bases its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program.

The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the Approved Enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the Approved Enterprise’s ordinary course of business. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an Approved Enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a consumer price index linkage adjustment and interest.

The Investments Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an Approved Enterprise program in the first five years of using the equipment.

Taxable income of a company derived from an Approved Enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period.

Should we derive income from sources other than the Approved Enterprise during the relevant period of benefits, such income will be taxable at the regular corporate tax rates.

Under certain circumstances (as further detailed below), the benefit period may extend to a maximum of ten years from the commencement of the benefit period.

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company’s undistributed income derived from the Approved Enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, after the commencement of production, depending on the geographic location of the Approved Enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The year’s limitation does not apply to the exemption period.





A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise(s) during the tax exemption period will be subject to corporate tax in the year the dividend is distributed in respect of the gross amount distributed, at the rate which would have been applicable had the company not elected the alternative package of benefits, (generally 10%-25%, depending on the percentage of the company's ordinary shares held by foreign shareholders). The dividend recipient is subject to withholding tax at the reduced rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. In the event, however, that the company qualifies as a foreign investors' company, there is no such time limitation.

As of December 31, 2016, we believe that we met the aforementioned conditions.

#### Foreign Investors' Company ("FIC")

A company that has an Approved Enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company of which, among other criteria, more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be entitled to the following:

- Extension of the benefit period to up to ten years.

- An additional period of reduced corporate tax liability at rates ranging between 10% and 25%, depending on the level of foreign (that is, non-Israeli) ownership of our shares.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company's effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year's profits to declare dividends.

In 1998, the production facilities of the Company related to its computational technologies were granted the status of an "Approved Enterprise" under the Law. In 2004, an expansion program was granted the status of "Approved Enterprise." According to the provisions of the Law, the Company has elected the alternative package of benefits and has waived Government grants in return for tax benefits.

#### Tax Benefits under the 2005 Amendment

An amendment to the Investments Law, generally referred as the 2005 Amendment, effective as of April 1, 2005 has significantly changed the provisions of the Investments Law. The amendment includes revisions to the criteria for investments qualified to receive tax benefits as an Approved Enterprise. The 2005 Amendment applies to new investment programs and investment programs commencing after 2004, and does not apply to investment programs approved prior to December 31, 2004, and therefore to benefits included in any certificate of approval that was granted before the 2005 Amendment came into effect, which will remain subject to the provisions of the Investments Law as they were on the date of such approval.

However, a company that was granted benefits according to Section 51 of the Investments Law (prior the 2005 Amendment) will not be allowed to choose a new tax year as a "Year of Election," referred to below, under the 2005 Amendment, for a period of two years from the company's previous Commencement Year (referred to below) under the old Investments Law.

The 2005 Amendment simplifies the approval process for the approved enterprise. According to the 2005 Amendment, only approved enterprises receiving cash grants require the approval of the Investment Center.

As a result of the 2005 Amendment, it is no longer necessary for a company to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Route, and therefore such companies need not apply to the Investment Center for this purpose. Rather, a company may claim the tax benefits offered by the Investments Law directly in its tax returns or by notifying the Israeli Tax Authority within twelve months of the end of that year, provided that its facilities meet the criteria for tax benefits set out by the 2005 Amendment. Such enterprise is referred to as the Benefited Enterprise. Companies are also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the 2005 Amendment. The 2005 Amendment includes provisions attempting to ensure that a company will not enjoy both Government grants and tax benefits for the same investment program.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise, or the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted average of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets at the end of the year before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the Commencement Year, or twelve years from the first day of the Year of Election. The Commencement Year is defined as the later of (a) the first tax year in which a company had derived income for tax purposes from the Beneficiary Enterprise or (b) the year in which a company requested to have the tax benefits apply to the Beneficiary Enterprise – Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following tax routes, which may be applicable to us:

Similar to the aforementioned alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) in respect of the gross amount of the dividend that we may be distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and

A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is Abundant in Foreign Investment (owned by at least 74% foreign shareholders and has undertaken to invest a minimum sum of \$20 million in the Benefited Enterprise as defined in the Investments Law) is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The 2005 Amendment changes the definition of "foreign investment" in the Investments Law so that the definition requires a minimal investment of ILS 5.0 million by foreign investors. Furthermore, such definition also includes the purchase of shares of a company from another shareholder, provided that the company's outstanding and paid-up share capital exceeds ILS 5.0 million. Such changes to the aforementioned definition took effect retroactively from 2003.



As a result of the 2005 Amendment, tax-exempt income generated under the provisions of the Investments Law, as amended, will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income.

We elected the years of 2006 and 2009 as “year of election” under the Investments Law after the 2005 Amendment.

We expect that a substantial portion of any taxable operating income that we may realize in the future will be derived from our approved enterprise status.

As of December 31, 2016, we did not generate exempt income under the provisions of the Investments Law.

#### Tax Benefits under the 2011 Amendment

As of January 1, 2011 new legislation amending the Investment Law came into effect (the “2011 Amendment”). The 2011 Amendment introduced a new status of “Preferred Company” and “Preferred Enterprise”, replacing the then existing status of “Benefited Company” and “Benefited Enterprise”. Similar to a “Benefited Company”, a Preferred Company is an industrial company owning a Preferred Enterprise which meets certain conditions (including a minimum threshold of 25% export). However, under this legislation the requirement for a minimum investment in productive assets was cancelled.

Under the 2011 Amendment, a uniform corporate tax rate applies to all qualifying income of the Preferred Company, as opposed to the former law, which was limited to income from the Approved Enterprises and Benefited Enterprise during the benefits period. The uniform corporate tax rate was 9% in areas in Israel designated as Development Zone A and 16% elsewhere in Israel during 2015 and 2016, an amendment to the Investment law from December 2016 reduced the tax rate in Development Zone A to 7.5% starting from 2017 while the tax rate in other areas remains 16%.

A dividend distributed from income which is attributed to a Preferred Enterprise/Special Preferred Enterprise will be subject to withholding tax at source at the following rates: (i) Israeli resident corporation –0%, (ii) Israeli resident individual – 20% in 2014 and onwards (iii) non-Israeli resident - 20% in 2014 and onwards, subject to a reduced tax rate under the provisions of an applicable double tax treaty.

The provisions of the 2011 Amendment also provided transitional provisions to address companies already enjoying current benefits. These transitional provisions provide, among other things, that unless an irrevocable request is made to apply the provisions of the Investment Law as amended in 2011 with respect to income to be derived as of January 1, 2011: (i) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which chose to receive grants, before the 2011 Amendment came into effect, will remain subject to the provisions of the Investment Law as in effect on the date of such approval, and subject to certain conditions; (ii) terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which had participated in an alternative benefits program, before the 2011 Amendment came into effect will remain subject to the provisions of the Investment Law as in effect on the date of such approval, provided that certain conditions are met; and (iii) a Benefited Enterprise can elect to continue to benefit from the benefits provided to it before the 2011 Amendment came into effect, provided that certain conditions are met.

Under the transition provisions of the new legislation, a company may decide to irrevocably implement the new law while waiving benefits provided under the current law or to remain subject to the current law. We have examined the possible effect, if any, of these provisions of the 2011 Amendment on our financial statements and have decided, at this time, not to opt to apply the new benefits under the 2011 Amendment.

### Tax Benefits under the 2016 Amendment

In December 2016 new legislation amended the Investment Law (the “2016 Amendment”). Under the 2016 Amendment a new status of “Technological Preferred Enterprise” was introduced to the Investment Law.

Under the 2016 Amendment two new tracks are available:

Technological Preferred Enterprise – an enterprise which is part of a consolidated group with consolidated revenues of less than ILS 10 billion. A Technological Preferred Enterprise which is located in areas other than Development Zone A will be subject to tax at a rate of 12% on profits derived from intellectual property, and a Technological Preferred Enterprise in Development Zone A will be subject to tax at a rate of 7.5%; and

Special Technological Preferred Enterprise – an enterprise which is part of a consolidated group with consolidated revenues exceeding ILS 10 billion. Such an enterprise will be subject to tax at a rate of 6% on profits derived from intellectual property regardless of the enterprise’s geographical location.

Any dividends distributed to foreign companies, as defined in the Investment law, derived from income from the Technological Preferred Enterprise will be subject to tax at a rate of 4%.

The implementation of the new tracks under the 2016 Amendment is subject to regulations to be promulgated by the Finance Minister by March 31, 2017. As such regulations have not yet been promulgated and as the definitive criteria to determine the tax benefits have not yet been established, it cannot be concluded that the legislation with respect to Technological Preferred Enterprises had been enacted or substantively enacted as of that date. Accordingly, the above changes in the tax rates were not taken into account in the computation of deferred taxes as of December 31, 2016.

### Special Provisions Relating to Tax Reporting in United States Dollars

Under the Income Tax (Inflationary Adjustments) Law, 1985, results for tax purposes are measured in real terms, in accordance with the changes in the Israeli Consumer Price Index (“Israeli CPI”). Accordingly, until 2011, results for tax purposes were measured in terms of earnings in ILS after certain adjustments for increases in the Israeli CPI. Commencing in the taxable year 2012, we have elected to measure our taxable income and file our tax return in United States Dollars, under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986.

### 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 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, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

As of January 1, 2012, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain is generally taxed at a rate of 30%. Additionally, if such shareholder is considered a “material shareholder” at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in a company, the

tax rate is 30%. Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of shares. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).



The tax basis of shares acquired prior to January 1, 2003 is 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.

In addition, as of January 1, 2013, shareholders that are individuals who have taxable income that exceeds ILS 800,000 in a tax year (linked to the CPI each year - ILS 803,520 in 2016), will be subject to an additional tax, referred to as High Income Tax, at the rate of 2% on their taxable income for such tax year which is in excess of such amount. Starting from January 1, 2017, the High Income tax rate has increased to 3% and its threshold has been lowered to 640,000 ILS. For this purpose taxable income will include taxable capital gains from the sale of our shares and taxable income from dividend distributions.

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

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the Convention between the government of the United States and the government of Israel with respect to taxes on income, as amended (the "U.S.-Israel Tax Treaty"), the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if (i) such U.S. resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such U.S. resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

#### United States Federal Income Taxation

The following is a description of the material United States federal income tax consequences of the ownership and disposition of our ordinary shares. This description addresses only the United States federal income tax considerations of holders that hold such ordinary shares as capital assets. This description does not address tax considerations applicable to holders that may be subject to special tax rules, including:

- financial institutions or insurance companies;
- real estate investment trusts, regulated investment companies or grantor trusts;
- dealers or traders in securities or currencies;
- tax-exempt entities;

· certain former citizens or long-term residents of the United States;

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- persons that will hold our shares through a partnership or other pass-through entity;
- persons that received our shares as compensation for the performance of services;
- persons that will hold our shares as part of a “hedging” or “conversion” transaction or as a position in a “straddle” for United States federal income tax purposes;
- persons whose “functional currency” is not the United States dollar; or
- holders that own directly, indirectly or through attribution 10.0% or more of the voting power or value of our shares.

Moreover, this description does not address the United States federal estate and gift or alternative minimum tax consequences of the ownership and disposition of our ordinary shares.

This description is based on the U.S. Internal Revenue Code of 1986, as amended, existing, proposed and temporary United States Treasury Regulations and judicial and administrative interpretations thereof, in each case as in effect and available on the date hereof. All of the foregoing are subject to change, which change could apply retroactively and could affect the tax consequences described below.

For purposes of this description, a “U.S. Holder” is a beneficial owner of our ordinary shares that, for United States federal income tax purposes, is:

- a citizen or individual resident of the United States;
- a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any state thereof, including the District of Columbia;
- an estate the income of which is subject to United States federal income taxation regardless of its source; or
- a trust if such trust has validly elected to be treated as a United States person for United States federal income tax purposes or if (1) a court within the United States is able to exercise primary supervision over its administration and (2) one or more United States persons have the authority to control all of the substantial decisions of such trust.

A “Non-U.S. Holder” is a beneficial owner of our ordinary shares that is neither a U.S. Holder nor a partnership (or other entity treated as a partnership for United States federal income tax purposes).

If a partnership (or any other entity treated as a partnership for United States federal income tax purposes) holds our ordinary shares, the tax treatment of a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such a partner or partnership should consult its tax advisor as to its tax consequences.

You should consult your tax advisor with respect to the United States federal, state, local and foreign tax consequences of owning and disposing of our ordinary shares.

## Distributions

Subject to the discussion below under “Passive Foreign Investment Company Considerations,” if you are a U.S. Holder, for United States federal income tax purposes, the gross amount of any distribution made to you, with respect to our ordinary shares before reduction of any Israeli taxes withheld therefrom, other than certain distributions, if any, of our ordinary shares distribute pro rata to all our shareholders, will be includible in your income as dividend income to the extent such distribution is paid out of our current or accumulated earnings and profits as determined under United States federal income tax principles. Subject to the discussion below under “Passive Foreign Investment Company Considerations,” non-corporate U.S. Holders may qualify for the lower rates of taxation with respect to dividends on ordinary shares applicable to long-term capital gains (that is, gains from the sale of capital assets held for more than one year), provided that certain conditions are met, including certain holding period requirements and the absence of certain risk reduction transactions. However, such dividends will not be eligible for the dividends received deduction generally allowed to corporate U.S. Holders. Subject to the discussion below under “Passive Foreign Investment Company Considerations,” to the extent, if any, that the amount of any distribution by us exceeds our current and accumulated earnings and profits as determined under United States federal income tax principles, it will be treated first as a tax-free return of your adjusted tax basis in our ordinary shares and thereafter as capital gain. We do not expect to maintain calculations of our earnings and profits under United States federal income tax principles and, therefore, if you are a U.S. Holder you should expect that the entire amount of any distribution generally will be reported as dividend income to you.

If you are a U.S. Holder, dividends paid to you with respect to your ordinary shares will be treated as foreign source income, which may be relevant in calculating your foreign tax credit limitation. Subject to certain conditions and limitations, Israeli tax withheld on dividends may be deducted from your taxable income or credited against your United States federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends that we distribute generally should constitute “passive category income,” or, in the case of certain U.S. Holders, “general category income.” A foreign tax credit for foreign taxes imposed on distributions may be denied when you do not satisfy certain minimum holding period requirements. In addition, for periods in which we are a “United States-owned foreign corporation”, a portion of dividends paid by us may be treated as U.S. source solely for purposes of the foreign tax credit. We would be treated as a United States-owned foreign corporation if 50% or more of the total value or total voting power of our stock is owned, directly, indirectly or by attribution, by United States persons. To the extent any portion of our dividends is treated as U.S. source income pursuant to this rule, the ability of a U.S. Holder to claim a foreign tax credit for any Israeli withholding taxes payable in respect of our dividends may be limited. A U.S. Holder entitled to benefits under the United States-Israel Tax Treaty may, however, elect to treat any dividends as foreign source income for foreign tax credit purposes if the dividend income is separated from other income items for purposes of calculating the U.S. Holder’s foreign tax credit. The rules relating to the determination of the foreign tax credit are complex, and you should consult your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to the discussion below under “Backup Withholding Tax and Information Reporting Requirements,” if you are a Non-U.S. Holder, you generally will not be subject to United States federal income or withholding tax on dividends received by you on your ordinary shares, unless you conduct a trade or business in the United States and such income is effectively connected with that trade or business.(or, if required by an applicable income tax treaty, the dividends are attributable to a permanent establishment that such holder maintains in the United States).

## Sales Exchange or other Disposition of Ordinary Shares

Subject to the discussion below under “Passive Foreign Investment Company Considerations,” if you are a U.S. Holder, you generally will recognize gain or loss on the sale, exchange or other disposition of our ordinary shares equal to the difference between the amount realized on such sale, exchange or other disposition and your adjusted tax basis in our ordinary shares. Such gain or loss will be capital gain or loss. If you are a non-corporate U.S. Holder, capital gain from the sale, exchange or other disposition of ordinary shares is eligible for the preferential rate of taxation

applicable to long-term capital gains if your holding period for such ordinary shares exceeds one year (that is, such gain is long-term capital gain). Gain or loss, if any, recognized by you generally will be treated as United States source income or loss for United States foreign tax credit purposes. The deductibility of capital losses for U.S. federal income tax purposes is subject to limitations.

Subject to the discussion below under “Backup Withholding Tax and Information Reporting Requirements,” if you are a Non-U.S. Holder, you generally will not be subject to United States federal income or withholding tax on any gain realized on the sale or exchange of our ordinary shares unless:

· such gain is effectively connected with your conduct of a trade or business in the United States (or, if required by an applicable income tax treaty, the gain is attributable to a permanent establishment that you maintain in the United States); or

· you are an individual and have been present in the United States for 183 days or more in the taxable year of such sale or exchange and certain other conditions are met.

#### Passive Foreign Investment Company Considerations

A non-U.S. corporation will be classified as a “passive foreign investment company,” or a PFIC, for United States federal income tax purposes in any taxable year in which, after applying certain look-through rules, either:

· at least 75 percent of its gross income is “passive income”; or

· at least 50 percent of the average value of its gross assets (based on the quarterly value of such gross assets) is attributable to assets that produce “passive income” or are held for the production of passive income.

Passive income for this purpose generally includes dividends, interest, royalties, rents, gains from commodities and securities transactions and the excess of gains over losses from the disposition of assets which produce passive income.

PFIC status is an annual determination that is based on tests which are factual in nature and our status in future years will depend on our income, assets and activities in each of those years. Therefore there can be no assurance that we will not be considered a PFIC for any taxable year. While public companies often employ a market capitalization method to value their assets, the IRS has not issued guidance concerning how to value a foreign public company’s assets for PFIC purposes. The market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has been especially volatile. In certain circumstances, including volatile market conditions, it may be appropriate to employ alternative methods to more accurately determine the fair market value of our assets other than the market capitalization method. Given the volatility of the capital markets in recent years, we have obtained an independent valuation of our company for the 2016 tax year, as well as an opinion from a U.S. tax advisor that, applying the results of the independent valuation of our company which employed an approach other than the market capitalization approach, and which provided the reasoning underlying the use of such approach, we should not be a PFIC for the 2016 taxable year. We considered such valuation in determining the value of our total assets and we also considered the above-referenced opinion. On that basis, we believe that we were not a PFIC for the 2016 tax year. However there can be no certainty that the IRS will not challenge such a position and determine that based on the IRS’s interpretation of the asset test, we were a PFIC for the 2016 tax year. If we were a PFIC, and you are a U.S. Holder, you generally would be subject to ordinary income tax rates, imputed interest charges and other disadvantageous tax treatment (including the denial of the taxation of such dividends at the lower rates applicable to long-term capital gains, as discussed above under “–Distributions”) with respect to any gain from the sale, exchange or other disposition of, and certain distributions with respect to, your ordinary shares. A U.S. Holder should consult his, her or its own tax advisor with respect to the potential application of the PFIC rules in his, her or its particular circumstances.

Because the market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has been especially volatile, and because that market price may affect the determination of whether we will be considered a PFIC, we cannot assure you that we will not be considered a PFIC for any taxable year.

Under the PFIC rules, unless a U.S. Holder makes one of the elections described in the next paragraphs, a special tax regime will apply to both (a) any “excess distribution” by us (generally, the U.S. Holder’s ratable portion of distributions in any year which are greater than 125% of the average annual distribution received by such U.S. Holder in the shorter of the three preceding years or the U.S. Holder’s holding period) and (b) any gain realized on the sale or other disposition of the ordinary shares. Under this regime, any excess distribution and realized gain will be treated as ordinary income and will be subject to tax as if (a) the excess distribution or gain had been realized ratably over the U.S. Holder’s holding period, (b) the amount deemed realized had been subject to tax in each year of that holding period, and (c) the interest charge generally applicable to underpayments of tax had been imposed on the taxes deemed to have been payable in those years. In addition, dividend distributions made to you will not qualify for the lower rates of taxation applicable to long term capital gains discussed above under “Distributions.”

Certain elections are available to U.S. Holders of shares that may serve to alleviate some of the adverse tax consequences of PFIC status. If we agreed to provide the necessary information, you could avoid the interest charge imposed by the PFIC rules by making a qualified electing fund, or a QEF election, which election may be made retroactively under certain circumstances, in which case you generally would be required to include in income on a current basis your pro rata share of our ordinary earnings as ordinary income and your pro rata share of our net capital gains as long-term capital gain. We do not expect to provide to U.S. Holders the information needed to report income and gain pursuant to a QEF election, and we make no undertaking to provide such information in the event that we are a PFIC.

Under an alternative tax regime, you may also avoid certain adverse tax consequences relating to PFIC status discussed above by making a mark-to-market election with respect to our ordinary shares annually, provided that the shares are “marketable.” Shares will be marketable if they are regularly traded on certain U.S. stock exchanges (including NASDAQ) or on certain non-U.S. stock exchanges. For these purposes, the shares will generally be considered regularly traded during any calendar year during which they are traded, other than in negligible quantities, on at least fifteen days during each calendar quarter.

If you choose to make a mark-to-market election, you would recognize as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the PFIC shares and your adjusted tax basis in the PFIC shares. Losses would be allowed only to the extent of net mark-to-market gain previously included by you under the election for prior taxable years. If the mark-to-market election were made, then the PFIC rules set forth above relating to excess distributions and realized gains would not apply for periods covered by the election. If you make a mark-to-market election after the beginning of your holding period of our ordinary shares, you would be subject to interest charges with respect to the inclusion of ordinary income attributable to the period before the effective date of such election.

Under certain circumstances, ordinary shares owned by a Non-U.S. Holder may be attributed to a U.S. person owning an interest, directly or indirectly, in the Non-U.S. Holder. In this event, distributions and other transactions in respect of such ordinary shares may be treated as excess distributions with respect to such U.S. person, and a QEF election may be made by such U.S. person with respect to its indirect interest in us, subject to the discussion in the preceding paragraphs.

We may invest in stock of non-U.S. corporations that are PFICs. In such a case, provided that we are classified as a PFIC, a U.S. Holder would be treated as owning its pro rata share of the stock of the PFIC owned by us. Such a U.S. Holder would be subject to the rules generally applicable to shareholders of PFICs discussed above with respect to distributions received by us from such a PFIC and dispositions by us of the stock of such a PFIC (even though the U.S. Holder may not have received the proceeds of such distribution or disposition). Assuming we receive the necessary information from the PFIC in which we own stock, certain U.S. Holders may make the QEF election discussed above with respect to the stock of the PFIC owned by us, with the consequences discussed above. However, no assurance can be given that we will be able to provide U.S. Holders with such information. A U.S. Holder generally would not be able to make the mark-to-market election described above with respect to the stock of any PFIC owned by us.

If we were a PFIC, a holder of ordinary shares that is a U.S. Holder must file United States Internal Revenue Service Form 8621 for each tax year in which the U.S. Holder owns the ordinary shares.

You should consult your own tax advisor regarding our potential status as a PFIC and the tax consequences and filing requirements that would arise if we were treated as a PFIC.



## Foreign Asset Reporting

Certain U.S. Holders who are individuals (and certain specified entities) are required to report information relating to an interest in ordinary shares, subject to certain exceptions (including an exception for securities held in certain accounts maintained by financial institutions). U.S. Holders are encouraged to consult their own tax advisers regarding the effect of this reporting requirement on their ownership and disposition of ordinary shares.

## 3.8% Medicare Tax on “Net Investment Income”

Certain U.S. Holders who are individuals, estates or trusts are required to pay an additional 3.8% tax on, among other things, dividends and capital gains from the sale or other disposition of ordinary shares. U.S. Holders are encouraged to consult their own tax advisers regarding the effect of this additional tax on their ownership and disposition of ordinary shares.

## Backup Withholding Tax and Information Reporting Requirements

United States backup withholding tax and information reporting requirements generally apply to certain payments to certain non-corporate holders of stock. Information reporting generally will apply to payments of dividends on, and to proceeds from the sale or redemption of, ordinary shares made within the United States, or by a United States payor or United States middleman, to a holder of ordinary shares, other than an exempt recipient (including a corporation, a payee that is not a United States person that provides an appropriate certification and certain other persons). A payor will be required to withhold backup withholding tax from any payments of dividends on, or the proceeds from the sale or redemption of, ordinary shares within the United States, or by a United States payor or United States middleman, to a holder, other than an exempt recipient, if such holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with, or establish an exemption from, such backup withholding tax requirements. The backup withholding tax rate currently is 28.0%.

Any amounts withheld under the backup withholding rules will be allowed as a refund or credit against the beneficial owner’s United States federal income tax liability, if any, provided that the required information is furnished to the IRS.

The above description is not intended to constitute a complete analysis of all tax consequences relating to ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.

## F. Dividends and Paying Agents

Not applicable.

## G. Statement by Experts

Not applicable.

## H. Documents on Display

We are currently subject to the information and periodic reporting requirements of the Exchange Act, and file periodic reports and other information with the SEC through its electronic data gathering, analysis and retrieval (EDGAR) system. Our securities filings, including this annual report and the exhibits thereto, are available for inspection and copying at the public reference facilities of the SEC located at Room 1580, 100 F Street, N.E., Washington, D.C. 20549. 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, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information

on the public reference room. The SEC also maintains a website at <http://www.sec.gov> from which certain filings may be accessed. As of November 2010, our filings are also available at the TASE's website at <http://maya.tase.co.il> and at the Israeli Securities Authority's website at <http://www.magna.isa.gov.il>. As permitted under NASDAQ Stock Market Rule 5250(d)(1)(C), we will post our annual reports filed with the SEC on our website at <http://www.allot.com>. We will furnish hard copies of such reports to our shareholders upon written request free of charge. The information contained on our website is not part of this or any other report filed with or furnished to the SEC.

As a foreign private issuer, we are exempt from the rules under the Exchange Act relating to the furnishing and content of proxy statements, and our officers, directors and principal shareholders will be exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. However, we are required to file with the SEC, within 120 days after the end of each subsequent fiscal year, an annual report on Form 20-F containing financial statements which will be examined and reported on, with an opinion expressed, by an independent public accounting firm. We also file with the SEC reports on Form 6-K containing quarterly unaudited financial information.

#### I. Subsidiary Information

Not applicable.

#### ITEM 11: Quantitative and Qualitative Disclosures About Market Risk

We are exposed to a variety of market risks, including foreign currency exchange fluctuations, changes in interest rates and inflation. We regularly assess currency, interest rate and inflation risks to minimize any adverse effects on our business as a result of those factors.

##### Risk of Interest Rate Fluctuation

The primary objectives of our investment activities are to preserve principal, support liquidity requirements, and maximize income without significantly increasing risk. Our investments are subject to market risk due to changes in interest rates, which may affect our interest income and fair market value of our investments.

To minimize this risk, we maintain our portfolio of cash, cash equivalents and short and long-term investments in a variety of securities, including U.S. government and agency securities, and corporate debt securities. We do not have any long-term borrowings. We have a significant amount of cash that is currently invested primarily in interest bearing investment such as bank time deposits, money market funds and available for sale marketable securities. These investments expose us to risks related to changes in interest rates. If interest rates further decline, our results of operations may be adversely affected due to lower interest income from these investments. We do not believe that a 10% increase or decrease in interest rates would have a material impact on our operating results, cash flows or the fair value of our portfolio. The primary objective of our investment activities is to preserve principal while maximizing the income that we receive from our investments without significantly increasing risk and loss. Our investments are exposed to market risk due to fluctuation in interest rates, which may affect our interest income and the fair market value of our investments. We manage this exposure by performing ongoing evaluations of our investments. Due to the short- and medium-term maturities nature of our investments to date, their carrying value approximates the fair value. We generally hold investments to maturity in order to limit our exposure to interest rate fluctuations.

##### Foreign Currency Exchange Risk

Our foreign currency exposures give rise to market risk associated with exchange rate movements of the U.S. dollar, our functional and reporting currency, mainly against the ILS. In 2016, we derived our revenues primarily in U.S. dollars and a substantial portion in Euros and other currencies. Although a substantial part of our expenses were denominated in U.S. dollars, a significant portion of our expenses were denominated in ILS and to a lesser extent in Euros and other currencies. Our ILS-denominated expenses consist principally of salaries and related personnel expenses. 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. Any strengthening or weakening in the value of the ILS against the U.S. is being partially mitigated using hedging transactions and therefore, though we cannot provide any assurance that such transaction will fully

mitigate the effect on our net income, it is not likely that such effect will be material.

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In the event of a 10% hypothetical strengthening or weakening in the value of the Euro against the U.S. dollar, we may be able to mitigate the effect of such currency exchange fluctuation by adapting our pricing. However, in the event that market conditions will limit our ability to adjust our pricing, we might not be able to fully mitigate the adverse effect of such currency fluctuation. We estimate that in such event, the impact on our net income in 2016 is not likely to exceed \$1,000,000. For more information regarding foreign currency related risks, see “ITEM 3: Key Information—Risk Factors—our international operations expose us to the risk of fluctuations in currency exchange rates.”

We use currency forward contracts together with currency options primarily to hedge payments in ILS. These transactions constitute a future cash flow hedge. As of December 31, 2016, we had outstanding forward contracts in the amount of \$13.3 million. These transactions were for a period of up to twelve months. As of December 31, 2016, the fair value of the above mentioned foreign currency derivative contracts was \$0.02 million.

ITEM 12: Description of Securities Other Than Equity Securities

Not applicable.

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PART II

ITEM 13: Defaults, Dividend Arrearages and Delinquencies

None.

ITEM 14: Material Modifications to the Rights of Security Holders and Use of Proceeds

A. Material Modifications to the Rights of Security Holders

None.

E. Use of Proceeds

The effective date of the registration statement (file no. 333-138313) for our initial public offering of ordinary shares, par value ILS 0.10, was November 15, 2006. We registered 6,500,000 ordinary shares in the offering and received net proceeds of \$70.5 million.

From the effective date of the registration statement and until December 31, 2016, the net proceeds had been invested in cash equivalents, marketable securities, capital expenditure and other corporate purposes. None of the net proceeds of the offering was paid directly or indirectly to any director, officer, general partner of ours or to their associates, persons owning ten percent or more of any class of our equity securities, or to any of our affiliates.

We conducted a subsequent public offering of our ordinary shares on November 15, 2011 raising net proceeds of \$85 million.

ITEM 15: Controls and Procedures

Disclosure Controls and Procedures. As of the end of the period covered by this report, our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2016. Based upon, and as of the date of, such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2016, our disclosures controls and procedures were effective such that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process 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. Our internal control over financial reporting includes those policies and procedures that:

pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016.

In making this assessment, our management used the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our management has concluded, based on its assessment, that our internal control over financial reporting was effective as of December 31, 2016 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external reporting purposes in accordance with generally accepted accounting principles.

Our independent auditors, Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, have issued an audit report on the effectiveness of our internal control over financial reporting. The report is included with our consolidated financial statements included elsewhere in this annual report.

Changes in Internal Control over Financial Reporting. During the period covered by this report, no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) have occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16: Reserved

ITEM 16A: Audit Committee Financial Expert

The board of directors has determined that Nurit Benjamini is an “audit committee financial expert” as defined under the U.S. federal securities laws and is independent under the rules of the NASDAQ Stock Market.

ITEM 16B: Code of Ethics

We have adopted a code of ethics applicable to our Chief Executive Officer, Chief Financial Officer, principal accounting officer or controller and persons performing similar functions. This code has been posted on our website, [www.allot.com](http://www.allot.com). Information contained on, or that can be accessed through, our website does not constitute a part of this annual report and is not incorporated by reference herein. Waivers of our code of ethics may only be granted by the board of directors. Under Item 16B of Form 20-F, if a waiver or amendment of the code of ethics applies to the persons specified in Item 16B(a) of the Form 20-F and relates to standards promoting any of the values described in Item 16B(b) of Form 20-F, we will disclose such waiver or amendment (i) on our website within five business days following the date of amendment or waiver in accordance with the requirements of Instruction 4 to such Item 16B or (ii) through the filing of a Form 6-K. We granted no waivers under our code of ethics in 2016.

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ITEM 16C: Principal Accountant Fees and Services

Fees paid to the Auditors

The following table sets forth, for each of the years indicated, the fees expensed by our independent registered public accounting firm.

	Year ended December, 31,	
	2015	2016
	(in thousands of U.S. dollars)	
Audit Fees(1)	\$ 265	\$ 238
Audit-Related Fees(2)	57	-
Tax Fees(3)	188	95
Total	\$ 510	\$ 333

“Audit fees” include fees for services performed by our independent public accounting firm in connection with our (1) annual audit for 2015 and 2016, certain procedures regarding our quarterly financial results submitted on Form 6-K and consultation concerning financial accounting and reporting standards.

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

(3) “Tax fees” include fees for professional services rendered by our independent registered public accounting firm for tax compliance, transfer pricing and tax advice on actual or contemplated transactions.

Audit Committee’s Pre-Approval Policies and Procedures

Our audit committee pre-approved all audit and non-audit services provided to us and to our subsidiaries during the periods listed above.

ITEM 16D: Exemptions from the Listing Standards for Audit Committees

Not applicable.

## ITEM 16E: Purchase of Equity Securities by the Company and Affiliated Purchasers

## Repurchase of Equity Securities

Period	(a) Total Number of Shares Purchased <sup>(1)</sup>	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(2)</sup>	(d) Maximum Dollar Value in millions of Shares That May Yet Be Purchased Under the Plans or Programs (in millions)
January 1 <sup>st</sup> – January 31 <sup>st</sup>	46,950	\$ 5.14	46,950	\$ 14.6
February 1 <sup>st</sup> – February 29 <sup>th</sup>	178,050	\$ 4.50	178,050	\$ 13.8
March 1 <sup>st</sup> – March 31 <sup>st</sup>	-	\$ -	-	\$ 13.8
April 1 <sup>st</sup> – April 30 <sup>th</sup>	-	\$ -	-	\$ 13.8
May 1 <sup>st</sup> – May 31 <sup>st</sup>	466,000	\$ 4.87	466,000	\$ 11.5
June 1 <sup>st</sup> – June 30 <sup>th</sup>	-	\$ -	-	\$ 11.5
July 1 <sup>st</sup> – July 31 <sup>st</sup>	-	\$ -	-	\$ 11.5
August 1 <sup>st</sup> – August 31 <sup>st</sup>	-	\$ -	-	\$ 11.5
September 1 <sup>st</sup> – September 30 <sup>th</sup>	-	\$ -	-	\$ 11.5
October 1 <sup>st</sup> – October 31 <sup>st</sup>	-	\$ -	-	\$ 11.5
November 1 <sup>st</sup> – November 30 <sup>th</sup>	100,000	\$ 4.98	100,000	\$ 11.0
December 1 <sup>st</sup> – December 31 <sup>st</sup>	-	\$ -	-	\$ 11.0
Total	791,000		\$ 791,000	

On August 2015, the Board of Directors approved a program for the Company to repurchase up to \$15 million of its outstanding ordinary shares, which program was thereafter approved by the Israeli court, pursuant to Israeli law on November 26, 2015. Share purchases will take place in open market transactions or in privately negotiated transactions and may be made from time to time depending on market conditions, share price, trading volume and (1) other factors. Such purchases will be made in accordance with all applicable securities laws and regulations. The repurchase program does not require Allot to acquire a specific number of shares, and may be suspended from time to time or discontinued. The court approvals previously granted were each valid for a period of six months. During 2016, we repurchased a total of 0.8 million shares of our ordinary shares for approximately \$3.8 million at an average price of \$4.82 per share under this program.

## ITEM 16F: Change in Registrant's Certifying Accountant

None.

## ITEM 16G: Corporate Governance

As a foreign private issuer, we are permitted under NASDAQ Rule 5615(a)(3) to follow Israeli corporate governance practices instead of the NASDAQ Stock Market requirements, provided we disclose which requirements we are not following and describe the equivalent Israeli requirement. We must also provide NASDAQ with a letter from outside counsel in our home country, Israel, certifying that our corporate governance practices are not prohibited by Israeli law.

We rely on this "foreign private issuer exemption" with respect to the following items:

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We follow the requirements of Israeli law with respect to the quorum requirement for meetings of our shareholders, which are different from the requirements of Rule 5620(c). Under our articles of association, the quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person, by proxy or by written ballot 33.33%, who hold or represent between them at least 25% of the voting power of our shares, instead of the issued share capital provided by under the NASDAQ requirements. This quorum requirement is based on the default requirement set forth in the Companies Law. We submitted a letter from our outside counsel in connection with this item prior to our initial public offering in November 2006.

We do not seek shareholder approval for equity compensation plans in accordance with the requirements of the Companies Law, which does not fully reflect the requirements of Rule 5635(c). Under Israeli law, we may amend our 2016 Plan by the approval of our board of directors, and without shareholder approval as is generally required under Rule 5635(c). Under Israeli law, the adoption and amendment of equity compensation plans, including changes to the reserved shares, do not require shareholder approval. We submitted a letter from our outside counsel in connection with this item in June 2008.

We are subject to additional Israeli corporate governance requirements applicable to companies incorporated in Israel whose securities are listed for trading on a stock exchange outside of Israel.

We may in the future provide NASDAQ with an additional letter or letters notifying NASDAQ that we are following our home country practices, consistent with the Companies Law and practices, in lieu of other requirements of Rule 5600.

ITEM 16H: Mine Safety Disclosure

Not applicable.

PART III

ITEM 17: Financial Statements

Not applicable.

ITEM 18: Financial Statements

See Financial Statements included at the end of this report.

ITEM 19: Exhibits

See exhibit index incorporated herein by reference.

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SIGNATURES

The registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

Allot Communications Ltd.

By: /s/ Erez Antebi  
Erez Antebi  
Chief Executive Officer and President

Dated: March 23, 2017

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ANNUAL REPORT ON FORM 20-F

INDEX OF EXHIBITS

Number	Description
1.1	Articles of Association of the Registrant (2)
1.2	Certificate of Name Change (1)
2.1	Specimen share certificate (1)
4.1	Non-Stabilized Lease Agreement, dated February 13, 2006, by and among, Aderet Hod Hasharon Ltd., Miritz, Inc., Leah and Israel Ruben Assets Ltd., Tamar and Moshe Cohen Assets Ltd., Drish Assets Ltd., S. L. A. A. Assets and Consulting Ltd., Iris Katz Ltd., Y. A. Groder Investments Ltd., Ginotel Hod Hasharon 2000 Ltd. and Allot Communications Ltd. (1)
4.2	2016 Incentive Compensation Plan, as amended and restated
4.3	Israeli Subplan (Appendix A) of the 2016 Incentive Compensation Plan, as amended and restated
4.4	US Subplan (Appendix B) of the 2016 Incentive Compensation Plan, as amended and restated
4.5	Manufacturing Agreement, dated July 19, 2007, by and between Flextronics (Israel) Ltd. and the Registrant (5)
4.6	Amendment No. 1, dated September 1, 2012, to the Manufacturing Agreement, dated July 19, 2007, by and between Flextronics (Israel) Ltd. and the Registrant*(3)
4.7	Asset Purchase Agreement, dated February 19, 2015, by and between Optenet S.A. and the Registrant. (4)
4.8	Compensation Policy for Executive Officers and Directors (6)
8.1	List of Subsidiaries of the Registrant
11.1	Code of Ethics (7)
12.1	Certification of Principal Executive Officer required by Rule 13a-14(a) and Rule 15d-14(a) (Section 302 Certifications)
12.2	Certification of Principal Financial Officer required by Rule 13a-14(a) and Rule 15d-14(a) (Section 302 Certifications)
13.1	Certification of Principal Executive Officer and Principal Financial Officer required by Rule 13a-14(b) and Rule 15d-14(b) (Section 906 Certifications), furnished herewith
15.1	Consent of Kost Forer Gabbay & Kasierer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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(1) Previously filed with the Securities and Exchange Commission on October 31, 2006 pursuant to a registration statement on Form F-1 (File No. 333-138313) and incorporated by reference herein.

(2) Previously filed with the Securities and Exchange Commission on March 26, 2014 as Exhibit 1.1 to Form 20-F for the year ended December 31, 2013 and incorporated by reference herein.

(3) Previously filed with the Securities and Exchange Commission on March 21, 2013 as Exhibit 4.7 to Form 20-F for the year ended December 31, 2012 and incorporated by reference herein.

(4) Previously filed with the Securities and Exchange Commission on March 26, 2015 as Exhibit 4.8 to Form 20-F for the year ended December 31, 2014 and incorporated by reference herein.

(5)

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Previously filed with the Securities and Exchange Commission on March 28, 2016 as Exhibit 5.1 to Form 20-F for the year ended December 31, 2015 and incorporated by reference herein.

(6) Previously included in Exhibit A-1 to Proxy statement included in Exhibit 99.1 to Form 6-K furnished to the Securities and Exchange Commission on August 15, 2016 and incorporated by reference herein.

(7) Previously filed with the Securities and Exchange Commission on June 28, 2007, as Exhibit 4 to Form 20-F for the year ended December 31, 2006 and incorporated by reference herein.

Portions of this exhibit were omitted and have been filed separately with the Secretary of the Securities and \*Exchange Commission pursuant to the Registrant's application requesting confidential treatment under Rule 24b-2 of the Exchange Act.



ALLOT COMMUNICATIONS LTD.

CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2016

U.S. DOLLARS IN THOUSANDS

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Kost Forer Gabbay & Kasierer Tel: +972-3-6232525  
3 Aminadav St. Fax: +972-3-5622555  
Tel-Aviv 6706703, Israel ey.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

ALLOT COMMUNICATIONS LTD.

We have audited the accompanying consolidated balance sheets of Allot Communications Ltd. ("the Company") as of December 31, 2016 and 2015, and the related consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016. 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 at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We have also 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, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 23, 2017 expressed an unqualified opinion thereon.

Tel  
Aviv, KOST FORER GABBAY & KASIERER  
Israel  
March  
23, A Member of Ernst & Young Global  
2017

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

ALLOT COMMUNICATIONS LTD.

We have audited Allot Communications Ltd. ("the Company") internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying management's report. 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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Kost Forer Gabbay & Kasierer Tel: +972-3-6232525  
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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 and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, 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, 2016 and 2015, and the related consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016 and our report dated March 23, 2017 expressed an unqualified opinion thereon.

Tel Aviv, Israel KOST FORER GABBAY & KASIERER  
March 23, 2017 A Member of Ernst & Young Global

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## ALLOT COMMUNICATIONS LTD.

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2016	2015
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$23,326	\$15,470
Restricted deposit	-	203
Short-term bank deposits	29,821	42,700
Available-for-sale marketable securities	60,507	64,921
Trade receivables (net of allowance for doubtful accounts of \$ 924 and \$ 657 at December 31, 2016 and 2015, respectively)	24,158	23,874
Other receivables and prepaid expenses	3,879	4,513
Inventories	7,235	10,169
<u>Total</u> current assets	148,926	161,850
<b>NON-CURRENT ASSETS:</b>		
Severance pay fund	252	282
Deferred taxes	267	501
Other assets	1,136	2,712
<u>Total</u> non-current assets	1,655	3,495
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>4,387</b>	<b>5,189</b>
<b>INTANGIBLE ASSETS, NET</b>	<b>4,410</b>	<b>6,119</b>
<b>GOODWILL</b>	<b>31,562</b>	<b>31,562</b>
<u>Total</u> assets	\$190,940	\$208,215

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

## ALLOT COMMUNICATIONS LTD.

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share and per share data

	December 31,	
	2016	2015
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$3,275	\$7,107
Employees and payroll accruals	7,381	8,211
Deferred revenues	11,133	14,066
Other payables and accrued expenses	3,157	5,710
<u>Total</u> current liabilities	24,946	35,094
<b>LONG-TERM LIABILITIES:</b>		
Deferred revenues	3,597	4,912
Accrued severance pay	592	651
Other long-term liability	4,502	4,153
<u>Total</u> long-term liabilities	8,691	9,716
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital -		
Ordinary shares of NIS 0.1 par value - Authorized: 200,000,000 shares at December 31, 2016 and 2015;		
Issued: 33,873,719 and 33,583,102 shares at December 31, 2016 and 2015, respectively;		
Outstanding:		
33,057,719 and 33,558,102 shares at December 31, 2016 and 2015, respectively	843	837
Additional paid-in capital	264,782	259,385
Treasury stock at cost - 816,000 and 25,000 shares at December 31, 2016 and 2015, respectively	(3,998 )	(166 )
Accumulated other comprehensive loss	(149 )	(470 )
Accumulated deficit	(104,175)	(96,181 )
<u>Total</u> shareholders' equity	157,303	163,405
<u>Total</u> liabilities and shareholders' equity	\$ 190,940	\$ 208,215

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

## ALLOT COMMUNICATIONS LTD.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

U.S. dollars in thousands, except share and per share data

	Year ended December 31,		
	2016	2015	2014
Revenues:			
Products	\$54,432	\$62,642	\$77,240
Services	35,937	37,325	39,946
<u>Total</u> revenues	90,369	99,967	117,186
Cost of revenues:			
Products	20,401	26,707	27,389
Services	7,494	6,720	7,350
<u>Total</u> cost of revenues	27,895	33,427	34,739
Gross profit	62,474	66,540	82,447
Operating expenses:			
Research and development (net of grant participations of \$ 606, \$ 1,252 and \$ 984 for the years ended December 31, 2016, 2015 and 2014, respectively)	24,221	26,422	29,014
Sales and marketing	35,290	43,318	44,599
General and administrative	9,812	12,702	11,941
<u>Total</u> operating expenses	69,323	82,442	85,554
Operating loss	(6,849)	(15,902)	(3,107)
Financial income (expense), net	1,059	(584)	660
Loss before income tax expense	(5,790)	(16,486)	(2,447)
Income tax expense	2,204	3,356	50
Net loss	\$(7,994)	\$(19,842)	\$(2,497)
Unrealized gain (loss) on available-for-sale marketable securities	337	(261)	(205)
Unrealized gain (loss) on foreign currency cash flow hedges transactions	(16)	1,411	(1,781)
Total comprehensive loss	\$(7,673)	\$(18,692)	\$(4,483)
Net loss per share:			
Basic and diluted	\$(0.24)	\$(0.59)	\$(0.08)
Weighted average number of shares used in per share computations of net loss:			
Basic and diluted	33,202,309	33,419,917	33,143,168

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





## ALLOT COMMUNICATIONS LTD.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Ordinary shares Outstanding shares	Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Accumulated deficit	Total shareholders' equity
Balance at January 1, 2014	32,877,118	\$ 774	\$ 242,629	\$-	\$ 366	\$(73,842 )	\$ 169,927
Exercise of stock options	442,805	45	1,431	-	-	-	1,476
Stock-based compensation	-	-	8,060	-	-	-	8,060
Other comprehensive loss	-	-	-	-	(1,986 )	-	(1,986 )
Net loss	-	-	-	-	-	(2,497 )	(2,497 )
Balance at December 31, 2014	33,319,923	819	252,120	-	(1,620 )	(76,339 )	174,980
Exercise of stock options	263,179	18	114	-	-	-	132
Treasury stock acquired, net *)	(25,000 )	-	-	(166 )	-	-	(166 )
Stock-based compensation	-	-	7,151	-	-	-	7,151
Other comprehensive income	-	-	-	-	1,150	-	1,150
Net loss	-	-	-	-	-	(19,842 )	(19,842 )
Balance at December 31, 2015	33,558,102	837	259,385	(166 )	(470 )	(96,181 )	163,405
Exercise of stock options	290,617	6	236	-	-	-	242
Treasury stock acquired, net *)	(791,000 )	-	-	(3,832 )	-	-	(3,832 )
Stock-based compensation	-	-	5,161	-	-	-	5,161
Other comprehensive income	-	-	-	-	321	-	321
Net loss	-	-	-	-	-	(7,994 )	(7,994 )
Balance at December 31, 2016	33,057,719	843	264,782	(3,998 )	(149 )	(104,175 )	157,303

\*) Including acquisition expenses of \$ 5 and \$ 35 for the years ended December 31, 2016 and 2015, respectively.

Accumulated other comprehensive loss:

Year ended  
December 31,

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	2016	2015	2014
Accumulated unrealized loss on available-for-sale marketable securities	\$(88 )	\$(425)	\$(164 )
Accumulated unrealized loss on foreign currency cash flows hedge transactions	(61 )	(45 )	(1,456)
Accumulated other comprehensive loss	\$(149)	\$(470)	\$(1,620)

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

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## ALLOT COMMUNICATIONS LTD.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2016	2015	2014
<u>Cash flows from operating activities:</u>			
Net loss	\$(7,994 )	\$(19,842)	\$(2,497 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	4,043	5,708	5,166
Impairment of intangible assets	-	5,777	-
Stock-based compensation	5,141	7,170	8,095
Capital loss	24	328	-
Increase (decrease) in accrued severance pay, net	(29 )	349	(8 )
Decrease in other assets	1,576	1,205	100
Decrease in accrued interest and amortization of premium on marketable securities	1,238	967	793
Increase in trade receivables	(284 )	(847 )	(6,851 )
Decrease (increase) in other receivables and prepaid expenses	699	(2,623 )	(1,321 )
Decrease (increase) in inventories	2,934	(60 )	3,689
Decrease (increase) in long-term deferred taxes, net	234	1,403	(224 )
Increase (decrease) in trade payables	(3,832 )	2,218	3,109
Increase (decrease) in employees and payroll accruals	(811 )	901	1,073
Increase (decrease) in deferred revenues	(4,248 )	1,961	1,911
Increase (decrease) in other payables and accrued expenses	(2,155 )	(429 )	2,800
Net cash provided by (used in) operating activities	(3,464 )	4,186	15,835
<u>Cash flows from investing activities:</u>			
Redemption of (Investment in) restricted cash	203	(203 )	-
Redemption of (Investment in) short-term deposits	12,879	16,300	(21,000)
Purchase of property and equipment	(1,582 )	(2,223 )	(3,391 )
Investment in available-for sale marketable securities	(29,695)	(34,098)	(22,736)
Proceeds from redemption or sale of marketable securities	33,208	22,221	8,266
Proceeds from sale of property and equipment	26	-	-
Loan granted to third party	-	-	(2,735 )
Repayment of loan to third party	-	-	652
Acquisition of Optenet, net of cash (see schedule A below)	-	(9,859 )	-
Net cash (used in) provided by investing activities	15,039	(7,862 )	(40,944)

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

## ALLOT COMMUNICATIONS LTD.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2016	2015	2014
<u>Cash flows from financing activities:</u>			
Proceeds from exercise of stock options	113	132	1,476
Purchase of treasury stock, net	(3,832 )	(166 )	-
Net cash provided by (used in) financing activities	(3,719 )	(34 )	1,476
Increase (decrease) in cash and cash equivalents	7,856	(3,710 )	(23,633)
Cash and cash equivalents at the beginning of the year	15,470	19,180	42,813
Cash and cash equivalents at the end of the year	\$23,326	\$15,470	\$19,180

Supplementary cash flow information:Cash paid (received) during the year for:

Taxes	\$175	\$139	\$82
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## Schedule A- Acquisition of Optenet:

Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows:

Working capital, net (excluding cash and cash equivalents)	\$-	\$(204 )	\$-
Equipment and other assets	-	152	-
Intangible assets	-	7,242	-
Goodwill	-	10,748	-
Total consideration	\$-	\$17,938	\$-
Non cash consideration	\$-	\$(8,079 )	\$-
Payment for acquisition, net of cash	\$-	\$9,859	\$-

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

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL

Allot Communications Ltd. (the "Company") was incorporated in November 1996 under the laws of the State of Israel. The Company is engaged in developing, selling and marketing intelligent service optimization and monetization solutions for mobile, fixed and cloud service providers, and enterprises. The Company's flexible and highly scalable service delivery framework, in the form of hardware platforms and software applications, leverages the intelligence in data networks enabling service providers to get closer to their customers; to safeguard network assets and users; and to accelerate time-to-revenue for value-added services. The Company's products consist of the Service Gateway and NetEnforcer service delivery platforms, the NetXplorer and Subscriber Management Platform network management and provisioning suites and value added services such as WebSafe Personal and Business Security solution, Service Protector network protection solution, ClearSee for Network analytics and MediaSwift E and VideoClass for media optimization.

The Company's Ordinary Shares are listed in the NASDAQ Global Select Market under the symbol "ALLT" from its initial public offering in November 2006. Since November, 2010, the Company's Ordinary Shares have been listed for trading in the Tel Aviv Stock Exchange as well.

The Company holds twelve wholly-owned subsidiaries (the Company together with said subsidiaries shall collectively be referred to as "Allot"): Allot Communications, Inc. in Woburn, Massachusetts, United-States (the "U.S. subsidiary"), which was incorporated in 1997 under the laws of the State of California, Allot Communication Europe SARL in Sophia, France (the "European subsidiary"), which was incorporated in 1998 under the laws of France, Allot Communications Japan K.K. in Tokyo, Japan (the "Japanese subsidiary"), which was incorporated in 2004 under the laws of Japan, Allot Communication (UK) Limited (the "UK subsidiary"), which was incorporated in 2006 under the laws of England and Wales, Allot Communications (Asia Pacific) Pte. Ltd. ("the Singaporean subsidiary"), which was incorporated in 2006 under the laws of Singapore, Allot Communications (New Zealand) Limited. (the "NZ subsidiary"), which was incorporated in 2007 under the laws of New Zealand, Allot India Private Limited. (the "Indian subsidiary"), which was incorporated in 2012 under the laws of India and commenced its activity in 2013, Allot Communications Africa (PTY) Ltd. (the "African subsidiary"), which was incorporated in 2013 under the laws of South Africa, Allot Communications (Hong Kong) Limited (the "HK subsidiary"), which was incorporated in 2013 under the laws of Hong-Kong, Allot Communications Spain, S.L. Sociedad Unipersonal (the "Spanish subsidiary"), which was incorporated in 2015 under the laws of Spain, Allot Communications (Colombia) S.A.S (the "Colombian subsidiary"), which was incorporated in 2015 under the laws of Colombia and Allot MexSub (the "Mexican subsidiary"), which was incorporated in 2015 under the laws of Mexico.

The U.S. subsidiary is engaged in the sale, marketing and technical support and development services in the Americas of products manufactured and imported by the Company. The European, Japanese, NZ, UK, Singaporean, Indian, HK African, Colombian and Mexican subsidiaries are engaged in marketing and technical support services of the Company's products in Europe, Japan, Oceania, UK, Asia, Africa and Latin America, respectively.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 1:- GENERAL (Cont.)

The Spanish subsidiary commenced its operations in 2015 and is engaged in the marketing, technical support and development activities of one of the Company's product lines.

## b. Acquisition:

On March 23, 2015 (the "Optenet acquisition date"), the Company entered into an asset purchase agreement (the "Optenet APA") with the shareholders of Optenet S.A. ("Optenet") a private, global IT security company that develops security solutions for internet service providers and enterprises.

The total consideration for the acquisition was \$ 17,938, which consisted of \$ 9,859 paid in cash and primarily an additional contingent consideration estimated at fair value of \$ 8,079 at the Optenet acquisition date. As of December 31, 2016 and 2015, the contingent consideration is estimated at fair value of \$ 4,504 and \$ 6,102, respectively. The change in fair value of the contingent consideration was recorded as reduction to general and administrative expenses.

The contingent consideration is payable over a five year term ending March 23, 2020 based on achievement of certain thresholds of revenues derived from Optenet's products and has payments cap of \$27,500. The obligation in respect of the contingent consideration is presented under Other payables and accrued expenses and Other long-term liability.

The acquisition was accounted for using the purchase method of accounting in accordance with ASC No. 805, "Business Combinations" ("ASC No. 805"). Accordingly, the purchase price was allocated according to the estimated fair values of the assets acquired and liabilities assumed and the excess of the purchase price over the net tangible and identified intangible assets was assigned to goodwill. The fair value of intangible assets was determined by management with the assistance of a third party valuation.

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

	Fair value
Current assets	\$ 54
Equipment	152
Deferred revenues	(155 )
Current and non-current liabilities	(103 )
Technology	4,032
Customer relationships	2,824
Backlog	386
Goodwill	10,748
Net assets acquired	\$ 17,938

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 1:- GENERAL (Cont.)

Technology includes security solutions for internet service providers and enterprises such as encompass parental control, anti-malware and anti-spam products. The technology is amortized over the estimated useful life of 4.34 years using the straight line method.

Backlog from customer orders is amortized over the estimated useful life of 2.8 years.

Customer relationships is derived from customer contracts and related customer relationships with existing customers. Customer relationships is amortized based on the accelerated method over the estimated useful life of 4.8 years.

The Company acquisition transaction costs amounted to \$ 397.

Unaudited pro forma condensed results of operations:

The following represents the unaudited consolidated pro forma revenue and net loss for the years ended December 31, 2015 and 2014, to give effect to the acquisition of Optenet as if it had occurred on January 1, 2014. The pro forma information is not necessarily indicative of the results of operations that would have been had the acquisition actually occurred on January 1, 2014, nor does it purport to represent the results of operations for future periods.

	Year ended December 31,	
	2015	2014
	Unaudited	
Revenues	\$ 100,683	\$ 124,244
Net loss	\$ (21,177 )	\$ (17,976 )

## c. Cost reduction plans:

During the third quarter of 2016, the Company initiated a limited restructuring plan to reduce its operating cost and improve its efficiency, mainly by reducing staff functions and some operations positions, as well as other measures. The restructuring expenses include mainly severance and other compensation related expenses associated with the termination of employment under a restructuring plan. The total restructuring costs in 2016 associated with exiting activities of the Company were \$ 1,290 and recorded in operating expenses. As of December 31, 2016, the total liability balance for the restructuring plan was \$ 309, mainly due to termination of employment expenses.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with U.S. 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 U.S. dollars:

The majority of the revenues of the Company and its subsidiaries are generated in U.S. dollars ("dollar") or linked to the dollar. In addition, a major portion of the Company's and certain of its subsidiaries' costs are incurred or determined in dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Accounting Standards Codification No. 830, "Foreign Currency Matters" ("ASC No. 830"). All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash and cash equivalents:

The Company considers all unrestricted highly liquid investments which are readily convertible into cash, with maturity of three months or less at the date of acquisition, to be cash equivalents.

e. Restricted deposits:

The restricted deposits are held in favor of financial institutions in respect of fulfillments of forward contract and operating obligations.





ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Short-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months but less than one year at the balance sheet date. The deposits are in dollars and bear interest at annual weighted average rate of 1.37% and 0.93% at December 31, 2016 and 2015, respectively.

g. Marketable securities:

The Company accounts for investments in marketable 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 comprehensive loss.

The Company's securities are reviewed for impairment in accordance with ASC 320-10-35. 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 Impairment (OTTI). 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. Based on the above factors, the Company concluded that unrealized losses on its available-for-sale securities, for the years ended 2016, 2015 and 2014, were not OTTI.

h. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising primarily from end of life products and from slow-moving items, technological obsolescence, and excess inventory. Inventory write-offs during the year ended December 31, 2016, 2015 and 2014 amounted to \$ 1,004, \$ 775 and \$ 4,097, respectively, and were recorded in cost of revenues for products.

Inventory write-off provision as of December 31, 2016 and 2015 amounted to \$ 1,957 and \$ 1,663, respectively.

Cost is determined using the weighted average cost method.

ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## i. Property and equipment, net:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	%
Lab equipment	25 - 33
Computers and peripheral equipment	15 - 33
Office furniture	6 - 15
Leasehold improvements	Over the shorter of the term of the lease or the useful life of the asset

## j. Goodwill impairment:

Goodwill represents the excess of the purchase price over the fair value of net assets of purchased businesses. Under Accounting Standards Codification No. 350, "Intangibles-Goodwill and Other" ("ASC No. 350"), goodwill is not amortized, but rather subject to an annual impairment test, or more often if there are indicators of impairment present. In accordance with ASC No. 350 the Company performs an annual impairment test at December 31 each year.

ASC 350 allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the qualitative assessment does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the two-step impairment test is performed. Alternatively, ASC 350 permits an entity to bypass the qualitative assessment for any reporting unit and proceed directly to performing the first step of the goodwill impairment test.

The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, the second step would need to be performed; otherwise, no further step is required. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value.

The Company operates in a single reportable unit. The Company has performed an annual impairment analysis as of December 31, 2016 and determined that the carrying value of the reporting unit was less than the fair value of the reporting unit. Fair value is determined using market capitalization. During years 2016, 2015 and 2014, no impairment losses were recorded.

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ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Impairment of long lived assets and intangible assets subject to amortization:

Property and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with ASC No. 360, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset 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.

Intangible assets acquired in a business combination are recorded at fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets that are not considered to have an indefinite useful life are amortized over their estimated useful lives. Some of the acquired intangible assets are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in accelerated amortization of such customer relationships as compared to the straight-line method. All other intangible assets are amortized over their estimated useful lives on a straight-line basis.

During the years ended December 31, 2016 and 2014, no impairment losses were recorded. During 2015, the Company recorded \$ 5,777 impairment loss (see Note 9).

l. Revenue recognition:

The Company generates revenues mainly from selling its products along with related maintenance and support services. At times, these arrangements may also include professional services, such as installation services or training. The Company generally sells its products through resellers, distributors, OEMs and system integrators, all of whom are considered end-users.

Revenues from product sales are recognized when persuasive evidence of an agreement exists, title and risk of loss have transferred, no significant performance obligations remain, product payment is not contingent upon performance of installation or service obligations, the fee is fixed or determinable and collectability is probable. In instances where acceptance of the product or service is specified by the customer, revenue recognition is deferred until all acceptance criteria have been met.

Maintenance and support related revenues included in multiple element arrangements are deferred and recognized on a straight-line basis over the term of the applicable maintenance and support agreement. Other services are recognized upon the completion of installation or when the service is provided. In instances where the services provided in a multiple element arrangement are considered essential to the functionality of the product and payment of the product is contingent upon performance of the services, the sales of the products and services would be considered one unit of accounting.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Pursuant to the guidance of ASU 2009-13, "Multiple-Deliverable Revenue Arrangements, (amendments to ASC Topic 605, Revenue Recognition)" (ASU 2009-13) and ASU 2009-14, when a sales arrangement contains multiple elements, such as products and services, the Company allocates revenues to each element based on a selling price hierarchy. The selling price for a deliverable is based on VSOE if available, third party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available. In multiple element arrangements, revenues are allocated to each separate unit of accounting for each of the deliverables using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy.

Revenue arrangements with multiple deliverables are allocated using the relative selling price method. The Company determines the estimated selling price in multiple elements arrangements as follows:

The Company determines the ESP in multiple-element arrangements for the products, based on reviewing historical transactions, and considering several other external and internal factors including, but not limited to, pricing practices including discounting and competition.

The Company determines the selling price for maintenance and support based on VSOE of the price charged based on standalone sales (renewals) of such elements using a consistent percentage of the Company's product price lists.

Deferred revenues are classified as short and long-term based on their contractual term and recognized as revenues at the time the respective elements are provided

The Company records a provision for estimated product returns based on its experience with historical product returns and other known factors. Such provisions amounted to \$ 910 and \$ 688 as of December 31, 2016 and 2015, respectively.

m. Advertising expenses:

Advertising expenses are charged to the statement of comprehensive loss, as incurred. Advertising expenses for the years ended December 31, 2016, 2015 and 2014 amounted to \$ 1,081, \$ 1,201 and \$ 1,131, respectively.

n. Research and development costs:

Accounting Standards Codification No. 985-20, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon the completion of a working model. The Company does not incur material costs between the completion of a working model and the point at which the products are ready for general release. Therefore, research and development costs are charged to the consolidated statement of comprehensive loss as incurred.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Severance pay:

The liability in Israel for substantially all of the Company's employees in respect of severance pay liability is calculated in accordance with Section 14 of the Severance Pay Law -1963 (herein- "Section 14"). Section 14 states that Company's contributions for severance pay shall be in line of severance compensation and upon release of the policy to the employee, no additional obligations 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.

Furthermore, the related obligation and amounts deposited on behalf of such obligation under Section 14, are not stated on the balance sheet, because pursuant to current ruling, they are legally released from obligation to employees once the deposits have been paid.

There are a limited number of employees in Israel, for whom the Company is liable for severance pay. The Company's liability for severance pay for its Israeli employees was calculated pursuant to Section 14, based on the most recent monthly salary of its Israeli employees multiplied by the number of years of employment as of the balance sheet date for such employees.

The Company's liability was partly provided by monthly deposits with severance pay funds and insurance policies and the remainder by an accrual.

Severance expense for the years ended December 31, 2016, 2015 and 2014, amounted to \$ 1,976, \$ 2,286 and \$ 2,092, respectively.

p. Restructuring costs:

The Company accounts for restructuring activities in accordance to ASC 712 "Compensation-Nonretirement Postemployment Benefits" ("ASC 712"), which requires that a liability for a cost associated with a contractual postemployment benefits be recognized and measured, initially at fair value, only when it is probable that the employees will be entitled to the benefits and the amount is estimable.

q. Accounting for stock-based compensation:

The Company accounts for stock based compensation in accordance with Accounting Standards Codification No. 718, "Compensation - Stock Compensation" ("ASC No. 718") that 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 statement of comprehensive loss. The Company recognizes compensation expenses for the value of its awards based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company accounted for changes in award terms as a modification in accordance with ASC 718. A modification to the terms of an award should be treated as an exchange of the original award for a new award with total compensation cost equal to the grant-date fair value of the original award plus the incremental value measured at the same date. Under ASC 718, the calculation of the incremental value is based on the excess of the fair value of the new (modified) award based on current circumstances over the fair value of the original award measured immediately before its terms are modified based on current circumstances.

ASC No. 718 requires forfeitures to be estimated at the time of the grant and revised in subsequent periods if actual forfeitures differ from those estimates.

The following table sets forth the total stock-based compensation expense resulting from stock options and restricted share units ("RSUs") granted to employees included in the consolidated statements of comprehensive loss, for the years ended December 31, 2016, 2015 and 2014:

	Year ended December 31,		
	2016	2015	2014
Cost of revenues	\$367	\$324	\$353
Research and development	1,240	1,637	1,919
Sales and marketing	1,833	2,802	3,322
General and administrative	1,701	2,407	2,501
Total stock-based compensation expense	\$5,141	\$7,170	\$8,095

The Company selected the binomial option pricing model as the most appropriate fair value method for its stock-based compensation awards with the following assumptions for the years ended December 31, 2016, 2015 and 2014:

	Year ended December 31,		
	2016	2015	2014
Suboptimal exercise multiple	2.9-3.5	3	3
Risk free interest rate	0.47%-1.58%	0.23%-2.35%	0.10%-2.73%
Volatility	33%-51%	37%-55%	44%-60%
Dividend yield	0%	0%	0%

The expected annual post-vesting and pre-vesting forfeiture rates affects the number of exercisable options. Based on the Company's historical experience, the annual pre-vesting and post-vesting are in the range of 0%-31% and 0%-29%, respectively, in the years 2016, 2015, and 2014.

The computations of expected volatility and suboptimal exercise multiple is based on the average of the Company's realized historical stock price. The computation of the suboptimal exercise multiple and the forfeiture rates are based

on the grantees expected exercise prior and post vesting termination behavior. The interest rate for period within the contractual life of the award is based on the U.S. Treasury Bills yield curve in effect at the time of grant.

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ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

The Company currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

The expected life of the stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the binomial model. The expected life of the stock options is impacted by all of the underlying assumptions used in the Company's model.

r. Treasury stock:

The Company repurchases its Ordinary shares from time to time on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity.

s. Concentration of credit risks:

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

The majority of cash and cash equivalents and short-term deposits of the Company are invested in dollar deposits in major U.S. and Israeli banks. Such investments in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally, the cash and cash equivalents and short-term bank deposits may be redeemed upon demand, and therefore, bear minimal risk.

Marketable securities include investments in dollar linked corporate and municipal bonds. Marketable securities consist of highly liquid debt instruments with high credit standing. The Company's investment policy, approved by the Board of Directors, limits the amount the Group may invest in any one type of investment or issuer, thereby reducing credit risk concentrations. Management believes that the portfolio is well diversified and, accordingly, minimal credit risk exists with respect to these marketable debt securities

The Company's trade receivables are primarily derived from sales to customers located mainly in EMEA, as well as in APAC, Latin America and the United States. Concentration of credit risk with respect to trade receivables is limited by credit limits, ongoing credit evaluation and account monitoring procedures. The Company performs ongoing credit evaluations of its customers and establishes an allowance for doubtful accounts on a specific basis. Allowance for doubtful accounts amounted to \$ 924 and \$ 657 as of December 31, 2016 and 2015, respectively.

The Company has no significant off balance sheet concentrations of credit risk.

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ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Grants from the Israel Innovation Authority:

Participation grants from the Israel Innovation Authority (Previously known as the Office of the Chief Scientist) for research and development activity are recognized at the time the Company is entitled to such grants on the basis of the costs incurred and included as a deduction of research and development costs. Research and development non royalty bearing grants recognized amounted to \$ 606, \$ 1,252 and \$ 984 in 2016, 2015 and 2014, respectively.

u. Income taxes:

The Company accounts for income taxes in accordance with Accounting Standards Codification No. 740, "Income Taxes" ("ASC No. 740"). ASC No. 740 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 their estimated realizable value if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

ASC No. 740 contains a two-step approach to recognizing and measuring a liability for 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% likely to be realized upon ultimate settlement.

v. Basic and diluted net income (loss) per share:

Basic net income (loss) per share is computed based on the weighted average number of Ordinary Shares outstanding during each year. Diluted net income (loss) per share is computed based on the weighted average number of Ordinary Shares outstanding during each year, plus dilutive potential Ordinary Shares considered outstanding during the year, in accordance with FASB ASC 260 "Earnings Per Share".

For the years ended December 31, 2016, 2015 and 2014, all outstanding options and RSUs have been excluded from the calculation of the diluted net loss per share since their effect was anti-dilutive. See Note 16.

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## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## w. Comprehensive income (loss):

The Company accounts for comprehensive income (loss) in accordance with Accounting Standards Codification No. 220, "Comprehensive Income" ("ASC No. 220"). This statement establishes standards for the reporting and display of comprehensive income (loss) and its components in a full set of general purpose financial statements. Comprehensive loss represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to shareholders. The Company determined that its items of comprehensive income (loss) relate to unrealized gains and losses on hedging derivative instruments and unrealized gains and losses on available-for-sale marketable securities.

The following table shows the components and the effects on net loss of amounts reclassified from accumulated other comprehensive loss as of December 31, 2016:

	Year ended December 31, 2016		
	Unrealized gains (losses)	Unrealized on gains (losses) marketable cash securities	Total
Balance as of December 31, 2015	\$ (425)	\$ (45 )	\$ (470)
Changes in other comprehensive income (loss) before reclassifications	293	226	519
Amounts reclassified from accumulated other comprehensive income (loss) to :			
Cost of revenues	-	(32 )	(32 )
Operating expenses	-	(210 )	(210)
Financial income, net	44	-	44
Net current-period other comprehensive income (loss)	337	(16 )	321
Balance as of December 31, 2016	\$ (88 )	\$ (61 )	\$ (149)

## x. Fair value of financial instruments:

The Company measures its cash and cash equivalents, marketable securities, derivative instruments, short-term bank deposits, trade receivables, other receivables, trade payables and other payables at fair value.

Fair value is an exit price, representing the amount that would be received if the Company were to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.



ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company uses a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Include other inputs that are directly or indirectly observable in the marketplace, other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with insufficient volume or infrequent transactions, or other inputs that are observable (model-derived valuations in which significant inputs are observable), or can be derived principally from or corroborated by observable market data; and

Level 3 - Unobservable inputs which are supported by little or no market activity.

The Company categorized each of its fair value measurements in one of those three levels of hierarchy. The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's earn-out consideration is classified within Level 3. The valuation methodology used by the Company to calculate the fair value consideration is the discounted cash flow using Monte-Carlo simulation method by taking into account, forecast future revenues, expected volatility of 39.2% and weighted average cost of debt of 2%.

y. Derivatives and hedging:

The Company accounts for derivatives and hedging based on Accounting Standards Codification No. 815, "Derivatives and Hedging" ("ASC No. 815").

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivative instruments that are not designated and qualified as hedging instruments must be adjusted to fair value through earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (loss) in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To apply hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

z. Business combinations:

The Company accounts for business combinations in accordance with ASC No. 805. ASC No. 805 requires recognition of assets acquired, liabilities assumed, and any non-controlling interest at the acquisition date, measured at their fair values as of that date. Any excess of the fair value of net assets acquired over the purchase price is recorded as goodwill and any subsequent changes in estimated contingencies are to be recorded in earnings. In addition, changes in valuation allowance related to acquired deferred tax assets and acquired income tax positions are to be recognized in earnings.

aa. Warranty costs:

The Company generally provides three months software and a one year hardware warranty for all of its products. A provision is recorded for estimated warranty costs at the time revenues are recognized based on the Company's experience. Warranty expenses for the years ended December 31, 2016, 2015 and 2014 were immaterial.

ab. Recently Issued Accounting Pronouncements:

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes", which simplifies the presentation of deferred income taxes. This ASU requires that deferred tax assets and liabilities be classified as non-current in a statement of financial position. The Company early adopted ASU 2015-17 effective December 31, 2015 on a prospective basis. No prior periods were retrospectively adjusted.

In January 2016, the FASB issued a new standard to amend certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the amendments is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than accumulated other comprehensive income (loss). ASU 2016-01 is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2017. Early adoption by public entities is permitted only for certain provisions. The Company is currently in the process of evaluating the impact of the adoption of this standard on its consolidated financial statements.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In February 2016, the FASB issued ASU 2016-02, "Leases", on the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to the accounting under existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASC 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation", which effects all entities that issue share-based payment awards to their employees. The amendments in this ASU cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. This ASU is effective for annual and interim periods beginning after December 15, 2016. This guidance can be applied either prospectively, retrospectively or using a modified retrospective transition method. Early adoption is permitted. The Company does not expect that this new guidance will have a material impact on the Company's Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). The standard changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU 2016-13 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company is currently evaluating the impact of this standard on its Consolidated Financial Statements.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18), which requires companies to include amounts generally described as restricted cash and restricted cash equivalents in cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. This new guidance doesn't have a material impact on the Company's Consolidated Financial Statements.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In May 2014, the FASB issued a new standard related to revenue recognition. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle of the new revenue recognition standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The FASB has recently issued several amendments to the standard, including clarification on identifying performance obligations.

The guidance permits two methods of modification: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the cumulative catch-up transition method). The Company has not yet selected a transition method.

The new standard will be effective for the Company beginning January 1, 2018, and adoption as of the original effective date of January 1, 2017 is permitted. The Company will adopt the new standard as of January 1, 2018.

The Company has made progress toward completing its evaluation of the potential changes from adopting this new standard on its financial reporting and disclosures. The Company has developed a project plan to analyze the potential impact this guidance will have on its consolidated financial statements and related disclosures as well as its business processes, systems and controls. This includes reviewing revenue contracts across all revenue streams and evaluating potential differences that would result from applying the requirements under the new guidance, including among others, the impact on specific performance obligations and variable consideration transactions. The Company is still currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

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## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 3:- AVAILABLE-FOR-SALE MARKETABLE SECURITIES

The following is a summary of available-for-sale marketable securities:

	December 31, 2016				December 31, 2015			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
Available-for-sale - matures within one year:								
Governmental debentures	\$339	\$ 0	\$ (0 )	\$339	\$293	\$ -	\$ (0 )	\$293
Corporate debentures	19,693	31	(14 )	19,710	20,077	1	(19 )	20,059
	20,032	31	(14 )	20,049	20,370	1	(19 )	20,352
Available-for-sale - matures after one year through three years:								
Governmental debentures	-	-	-	-	978	-	(6 )	972
Corporate debentures	34,472	70	(78 )	34,464	29,004	3	(230 )	28,777
	34,472	70	(78 )	34,464	29,982	3	(236 )	29,749
Available-for-sale - matures after three years through five years:								
Governmental debentures	100	-	-	100	344	-	(5 )	339
Corporate debentures	5,991	2	(99 )	5,894	14,650	5	(174 )	14,481
	6,091	2	(99 )	5,994	14,994	5	(179 )	14,820
	\$60,595	\$103	\$ (191 )	\$60,507	\$65,346	\$ 9	\$ (434 )	\$64,921

All investments with an unrealized loss as of December 31, 2016 are with continuous unrealized losses for less than 12 months.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 4:- FAIR VALUE MEASUREMENTS

In accordance with ASC No. 820, the Company measures its cash equivalents, marketable securities and foreign currency derivative instruments at fair value. Cash equivalents and available for sale marketable securities are classified within Level 1 or Level 2. This is because these assets are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

The earn-out liability related to the acquisition of Optenet is classified within Level 3 because this liability is based on present value calculations and an external valuation model whose inputs include market interest rates, estimated operational capitalization rates and volatilities.

The Company's financial net assets measured at fair value on a recurring basis, including accrued interest components, consisted of the following types of instruments as of December 31, 2016 and 2015, respectively:

	As of December 31, 2016			
	Fair value measurements using input type Level			
	1	Level 2	Level 3	Total
Available-for-sale marketable securities	\$ -	\$ 60,507	\$ -	\$ 60,507
Foreign currency derivative contracts	-	28	-	28
Earn-out liability	-	-	4,504	4,504
Total financial net assets	\$ -	\$ 60,535	\$ 4,504	\$ 65,039
	As of December 31, 2015			
	Fair value measurements using input type Level			
	1	Level 2	Level 3	Total
Available-for-sale marketable securities	\$ -	\$ 64,921	\$ -	\$ 64,921
Foreign currency derivative contracts	-	401	-	401
Earn-out liability	-	-	6,102	6,102
Total financial net assets	\$ -	\$ 65,322	\$ 6,102	\$ 71,424

Fair value measurements using significant unobservable inputs (Level 3):

Balance at January 1, 2016	\$6,102
Earn Out liability payments, settlements and adjustments due to exchange rates	(636 )
Adjustment due to change in the forecast of earn-out consideration	(962 )
Balance at December 31, 2016	\$4,504



## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 5:- DERIVATIVE INSTRUMENTS

The Company enters into hedge transactions with a major financial institution, using derivative instruments, primarily forward contracts and options to purchase and sell foreign currencies, in order to reduce the net currency exposure associated with anticipated expenses (primarily salaries and related expenses that are designated as cash flow hedges) in currencies other than U.S. dollar, and forecasted revenues denominated in Euro. The net income recognized in "Financial income, net" during the years ended December 31, 2016, 2015 and 2014 was \$ 286, \$ 1,200 and \$ 2,144, respectively.

The Company currently hedges such future exposures for a maximum period of one year. However, the Company may choose not to hedge certain foreign currency exchange exposures for a variety of reasons, including but not limited to immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange rates.

The Company records all derivatives on the consolidated balance sheets at fair value in accordance with ASC No. 820 at Level 2. The effective portion of cash flow hedges are recorded in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of cash flow hedges are adjusted to fair value through earnings in financial income (expenses), net. The Company does not enter into derivative transactions for trading purposes.

The Company had a net unrealized loss associated with cash flow hedges of \$ 61 and \$ 45 recorded in other comprehensive loss as of December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, the Company had outstanding hedge transactions in the amount of \$ 13,302 and \$ 18,361, respectively.

The fair value of the outstanding foreign exchange contracts recorded by the Company on its consolidated balance sheets as of December 31, 2016 and 2015, as assets and liabilities is as follows:

Foreign exchange forward and options contracts	Balance sheet	December 31,	
		2016	2015
Fair value of foreign exchange hedge transactions	Other receivables and prepaid expenses	\$40	\$104
Fair value of foreign exchange hedge transactions	Other payables and accrued expenses	(101)	(149)
Total derivatives designated as hedging instruments	Other Comprehensive loss	\$(61 )	\$(45 )

Gain or loss on the derivative instruments, which partially offset the foreign currency impact from the underlying exposures, reclassified from other comprehensive loss to operating expenses for the years ended December 31, 2016, 2015 and 2014 were \$ (242), \$ 1,407 and \$ 717, respectively.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 5:- DERIVATIVE INSTRUMENTS (Cont.)

Non-designated hedges:

The Company also uses foreign currency forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies. These derivatives do not qualify for special hedge accounting treatment. These derivatives are carried at fair value with changes recorded in financial income, net. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. Cash flows from such derivatives are classified as operating activities. The derivatives have maturities of approximately twelve months. As of December 31, 2016 and 2015, the Company's transactions were \$ 14,969 and \$ 14,901, respectively.

The fair value of the outstanding non-designated foreign exchange contracts recorded by the Company on its consolidated balance sheets as of December 31, 2016 and 2015, as assets and liabilities is as follows:

Foreign exchange forward and options contracts	Balance sheet	December 31,	
		2016	2015
Fair value of foreign exchange non-designated hedge transactions	Other receivables and prepaid expenses	\$ 181	\$ 459
Fair value of foreign exchange non-designated hedge transactions	Other payables and accrued expenses	(92 )	(13 )
Total derivatives designated as hedging instruments		\$ 89	\$ 446

## NOTE 6:- OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31,	
	2016	2015
Prepaid expenses	\$1,739	\$1,959
Government authorities	1,003	898
Receivable from third-party	426	-
Foreign currency derivative contracts	221	566
Short-term lease deposits	127	215
Grants receivable from the Israel Innovation Authority	-	728
Others	363	147
	\$3,879	\$4,513

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 7:- INVENTORIES

	December 31,	
	2016	2015
Raw materials	\$1,257	\$1,584
Finished goods	5,978	8,585
	\$7,235	\$10,169

As of December 31, 2016 and 2015, the finished products line item above includes deferral of the cost of goods sold for which revenue was not yet recognized in the amount of approximately \$ 512 and \$ 572, respectively.

## NOTE 8:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2016	2015
Cost:		
Lab equipment	\$13,225	\$12,527
Computers and peripheral equipment	18,704	18,667
Office furniture and equipment	975	955
Leasehold improvements	1,238	1,164
	34,142	33,313
Accumulated depreciation:		
Lab equipment	10,788	9,483
Computers and peripheral equipment	17,750	17,453
Office furniture and equipment	521	568
Leasehold improvements	696	620
	29,755	28,124
Depreciated cost	\$4,387	\$5,189

Depreciation expense for the years ended December 31, 2016, 2015 and 2014 was \$ 2,334, \$ 2,813 and \$ 3,308, respectively.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 9:- INTANGIBLE ASSETS, NET

a. The following table shows the Company's intangible assets for the periods presented:

	December 31,	
	2016	2015
Original Cost:		
Technology *)	\$9,111	\$9,111
Backlog	1,877	1,877
Customer relationships **)	3,592	3,592
	\$14,580	\$14,580
Accumulated amortization:		
Technology	\$6,705	\$5,765
Backlog	1,867	1,632
Customer relationships	1,598	1,064
	\$10,170	\$8,461
Amortized cost	\$4,410	\$6,119

\*) During 2015, the Company recorded an impairment loss of \$ 3,214 and \$ 2,432 related to technology purchased in 2012 from acquisitions of Ortiva Wireless Inc. and Oversi Networks Ltd. ("Oversis"), respectively, due to the Company's decision to reach end of life on the respective product lines. The impairment loss was recorded in cost of revenues.

\*\*\*) During 2015, the Company recorded an impairment loss of \$ 131 related to Oversis's customer relationships, due to the Company's decision to reach end of life on the respective product line. The impairment loss was recorded in sales and marketing.

b. Amortization expense for the years ended December 31, 2016, 2015 and 2014 was \$ 1,709, \$ 2,895 and \$ 1,858, respectively.

c. Estimated amortization expense for the years ending:

Year ending December 31,	
2017	1,478
2018	1,630
2019	1,302
Total	4,410





## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 10:- OTHER PAYABLES AND ACCRUED EXPENSES

	December 31,	
	2016	2015
Accrued expenses	\$2,255	\$1,758
Accrued taxes	416	473
Foreign currency derivative contracts	193	163
Advances from customers	23	1,103
Contingent consideration	-	1,949
Others	270	264
	<b>\$3,157</b>	<b>\$5,710</b>

## NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES

## a. Lease commitments:

The Company signed several non-cancelable agreements for its facilities which vary in dates and terms. In March 2013, the Company engaged in renting its main facilities for an average period of five years, starting July 2013. The total rental expenses are approximately \$ 144 per month.

The U.S. subsidiary has an operating lease for office facilities in Woburn, Massachusetts and in San Diego, California, the leases expire on August 31, 2019 and on April 30, 2018, respectively. The Spanish subsidiary has an operating lease for office facilities in Madrid, Spain, the leases expire within three month notice period. The Company's subsidiaries maintain smaller offices in South Africa, China, Singapore, Japan, New Zealand, Colombia and various locations in Europe.

In addition, the Company has operating lease agreements for its motor vehicles, which terminate in 2016 through 2019.

Operating leases (offices and motor vehicles) expense for the years ended December 31, 2016, 2015 and 2014 was \$ 2,758, \$ 2,828 and \$ 3,155, respectively.

As of December 31, 2016, the aggregate future minimum lease obligations (offices and motor vehicles) under non-cancelable operating leases agreements were as follows:

Year ending December 31,	
2017	\$2,480
2018	651
2019	103
Total	\$3,234



ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

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

b. Major subcontractor:

The Company currently depends on one subcontractor to manufacture and provide hardware, warranty and support for its traffic management systems. If the subcontractor experiences delays, disruptions, quality control problems or a loss in capacity, shipments of products may be delayed and the Company's ability to deliver products could be materially adversely affected. Certain hardware components for the Company's products come from single or limited sources, and the Company could lose sales if these sources fail to satisfy its supply requirements. In the event that the Company terminates its business connection with the subcontractor, it will have to compensate the subcontractor for certain inventory costs, as specified in the agreement with the subcontractor.

c. Litigations:

On November 8, 2016, a former employee filed a claim against the Company alleging that he is entitled to compensation for unlawful dismissal by the Company. A mediation attempt has failed, the Company is waiting for the first hearing to take place. The Company believes that it has valid defenses to the claim. According to the Company's legal counsel the award will not exceed \$ 32.

NOTE 12:- SHAREHOLDERS'  
EQUITY

a. Company's shares:

As of December 31, 2016, the Company's authorized share capital consists of NIS 20,000,000 divided into 200,000,000 Ordinary Shares, par value NIS 0.1 per share. Ordinary Shares confer on their holders the right to receive notice to participate and vote in general meetings of the Company, the right to a share in the excess of assets upon liquidation of the Company, and the right to receive dividends, if declared.

b. Treasury stock:

On August 2015, the Company's Board of Directors authorized the repurchase of up to an aggregate of \$ 15 million of the Company's Ordinary shares in the open market, subject to normal trading restrictions. During November 2015, the Company received court's approvals to purchase up to \$ 15 million of its ordinary shares. The court's approval for share repurchases was expired on May 26, 2016. On July 6, 2016, the Company received the court's approval to extend the share repurchase period for additional 6 months. During 2015 the Company purchased 25,000 of its Ordinary shares for a total consideration of \$ 166. During 2016 the Company purchased 791,000 of its Ordinary shares for a total consideration of \$ 3,832. Total consideration for the purchase of these Ordinary shares was recorded as Treasury stock, at cost, as part of shareholders' equity.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

## c. Stock option plan:

A summary of the Company's stock option activity, pertaining to its option plans for employees and related information is as follows:

	Year ended December 31,				2014	
	2016	2015	2015	2014	2014	2014
	Number	Weighted	Number	Weighted	Number	Weighted
	of shares	average	of shares	average	of shares	average
	upon	exercise	upon	exercise	upon	exercise
	exercise	price	exercise	price	exercise	price
Outstanding at beginning of year	2,811,966	\$ 10.70	2,531,381	\$ 11.99	2,875,003	\$ 12.02
Granted	643,697	\$ 4.99	704,348	\$ 6.73	572,533	\$ 11.93
Forfeited	(1,358,492)	\$ 12.41	(320,496)	\$ 15.13	(562,787)	\$ 17.02
Exercised	(138,157)	\$ 1.75	(103,267)	\$ 1.28	(353,368)	\$ 4.18
Outstanding at end of year	1,959,014	\$ 8.24	2,811,966	\$ 10.70	2,531,381	\$ 11.99
Exercisable at end of year	1,072,658	\$ 9.87	1,646,204	\$ 11.99	1,440,143	\$ 11.75
Vested and expected to vest	1,407,930	\$ 9.04	2,197,848	\$ 11.16	1,950,116	\$ 11.97

The aggregate intrinsic value represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fiscal years 2016, 2015 and 2014 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2016, 2015 and 2014, respectively. This amount may change based on the fair market value of the Company's stock. The total intrinsic value of options outstanding at December 31, 2016, 2015 and 2014, were \$ 728, \$ 1,580 and \$ 4,085, respectively. The total intrinsic value of exercisable options at December 31, 2016, 2015 and 2014, were approximately \$ 604, \$ 1,170 and \$ 2,983, respectively. The total intrinsic value of options vested and expected to vest at December 31, 2016, 2015 and 2014, were approximately \$ 634, \$ 1,363 and \$ 3,436, respectively.

The total intrinsic value of options exercised during the years ended December 31, 2016, 2015 and 2014 were approximately \$ 415, \$ 469 and \$ 1,901, respectively. The weighted-average grant-date fair value of the options granted during the years ended December 31, 2016, 2015 and 2014 were \$ 2.12, \$ 3.45 and \$ 6.31, respectively. The number of options vested during the year ended December 31, 2016 was 279,088. The weighted-average remaining contractual life of the outstanding options as of December 31, 2016 is 5.53 years. The weighted-average remaining contractual life of exercisable options as of December 31, 2016 is 4.99 years.

On May 2, 2016 the Board of Directors of the Company approved the repricing of 384,635 stock options for the Company's employees and executive officers, previously granted. As part of the repricing, options with exercise price higher than \$ 7 per share were repriced. Repriced options were replaced by options with lower exercise price or RSU's.



## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

The vesting period for the new granted options and RSU's was schedule for two years. The incremental expense for the repricing of the options was approximately \$ 470. For the year ended December 31, 2016, the Company recorded expenses totaling \$ 155 associated with the repricing.

The options outstanding as of December 31, 2016, have been classified by exercise price, as follows:

Exercise price	Shares upon exercise of options outstanding as of December 31, 2016	Weighted average remaining contractual life Years	Shares upon exercise of options exercisable as of December 31, 2016
\$23.31-27.58	73,000	5.62	73,000
\$15.20-17.07	129,059	4.75	123,088
\$10.16-14.68	383,233	6.59	297,998
\$5.01-9.25	827,398	5.43	321,964
\$0.03-4.95	546,324	5.12	256,608
	1,959,014		1,072,658

The following provides a summary of the restricted stock unit activity for the Company for the two years ended December 31, 2016:

	Year ended December 31, 2016		2015	
	Number of shares upon exercise	Weighted average share price	Number of shares upon exercise	Weighted average share price
Outstanding at beginning of year	359,404	\$ 10.95	445,264	\$ 12.43
Granted	531,570	\$ 4.59	158,551	\$ 8.52
Vested	(152,460)	\$ 10.08	(159,912)	\$ 11.22
Forfeited	(146,388)	\$ 6.85	(84,499 )	\$ 12.57
Unvested at end of year	592,126	\$ 6.53	359,404	\$ 10.95

As of December 31, 2016, \$ 2,194 and \$ 2,801 unrecognized compensation cost related to stock options and RSUs respectively is expected to be recognized over a weighted average vesting period of 2.34 years.

As of December 31, 2016, the Company holds outstanding options under the 2016 option plan (formerly, 2006 Plan). The outstanding options and RSUs under the 2016 plan are exercisable to 1,959,014 and 592,126 Ordinary shares respectively.



ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

Under the terms of the above option plans, options may be granted to employees, officers, directors and various service providers of the Company and its subsidiaries. The options generally become exercisable quarterly over a four-year period, commencing one year after date of the grant, subject to the continued employment of the employee. The options generally expire no later than ten years from the date of the grant. The exercise price of the options at the date of grant under the plans may not be less than the nominal value of the shares into which such options are exercised, any options, which are forfeited or cancelled before expiration, become available for future grants. As of December 31, 2016, 807,322 Ordinary shares are available for future issuance under the option plans.

In 2015 the Company granted 1,732 options to employees with an exercise price of \$ 0.03, which was lower than the trading price of the Company's Ordinary Shares quoted on the NASDAQ Global Select Market on the date of the grants. During 2016, the Company did not grant options with an exercise price lower than the trading price of the Company's Ordinary Shares.

In addition to granting stock options, the Company granted 531,570 and 158,551 RSUs in 2016 and 2015, respectively under the 2016 option plan. RSUs vest over a four year period subject to the continued employment of the employee. RSUs that are cancelled or forfeited become available for future grants.

NOTE 13:- TAXES ON INCOME

a. Corporate tax rates:

The Israeli corporate income tax rate was 25% in 2016 and 26.5% in 2015 and 2014.

In January 2016, the Law for Amending the Income Tax Ordinance (No. 216) (Reduction of Corporate Tax Rate), 2016 was approved, which includes a reduction of the corporate tax rate from 26.5% to 25%, effective from January 1, 2016.

In December 2016, a further reduction in the corporate tax rate to 24% effective January 2017 and to 23% effective January 1, 2018 and thereafter was enacted.

b. Foreign Exchange Regulations:

Commencing in taxable year 2013, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Foreign Tax Regulations. Under the Foreign Exchange Regulations, an Israeli company must calculate its tax liability in U.S. Dollars according to certain orders. The tax liability, as calculated in U.S. Dollars is translated into NIS according to the exchange rate as of December 31st of each year.



ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 13:- TAXES ON INCOME (Cont.)

c. Tax benefits under Israel's law for the Encouragement of Capital Investments, 1959 ("the Law"):

In 1998, the production facilities of the Company related to its computational technologies were granted the status of an "Approved Enterprise" under the Law. In 2004, expansion program was granted the status of "Approved Enterprise". According to the provisions of the Law, the Company has elected the alternative track of benefits and has waived Government grants in return for tax benefits. The period of tax benefits, detailed above, is limited to the earlier of 12 years from the commencement of production, or 14 years from the approval date.

According to the provisions of the Law under the alternative track, the Company's income may be tax-exempt for a period of two years commencing with the year it first earns taxable income, and subject to corporate taxes at the reduced rate of 10% to 25%, for an additional period of five to eight years depending upon the level of foreign ownership of the Company.

The Law was significantly amended effective April 1, 2005 ("the Amendment"). The Amendment includes revisions to the criteria for investments qualified to receive tax benefits as a Beneficiary Enterprise and among other things, simplifies the approval process. The Amendment applies to new investment programs. Therefore, investment programs commencing after December 31, 2004, do not affect the approved programs of the Company.

In addition, the Law provides that terms and benefits included in any letter of approval already granted will remain subject to the provisions of the Law as they were on the date of such approval. Therefore, the Company's existing Approved Enterprise will generally not be subject to the provisions of the Amendment. The Company elected 2006 and 2009 as "year of election" under the Amendment.

The entitlement to the above benefits is contingent upon the fulfillment of the conditions stipulated in the Law, regulations published there under and the criteria set forth in the specific letters of approval. In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest and linked to changes in the Israeli CPI. As of December 31, 2016, management believes that the Company meets the aforementioned conditions.

If the Company pays a dividend out of exempt income derived from the Approved and Beneficiary Enterprise, it will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not enjoyed the alternative benefits, generally 10%-25%, depending on the percentage of the Company's Ordinary shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The Company currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 13:- TAXES ON INCOME (Cont.)

As of December 31, 2016, there are no profits earned by the Company Israel's "Approved Enterprises" and "Beneficiary Enterprise".

Income from sources other than the "Approved and Beneficiary Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate.

As of January 1, 2011, new legislation amending the Investment Law came into effect (the "2011 Amendment"). The 2011 Amendment introduced a new status of "Preferred Company" and "Preferred Enterprise", replacing the then existing status of "Beneficiary Company" and "Beneficiary Enterprise". Similarly to "Beneficiary Company", a Preferred Company is an industrial company owning a Preferred Enterprise which meets certain conditions (including a minimum threshold of 25% export). However, under this new legislation the requirement for a minimum investment in productive assets was cancelled.

Under the 2011 Amendment, a uniform corporate tax rate will apply to all qualifying income of the Preferred Company, as opposed to the former law, which was limited to income from the Approved Enterprises and Beneficiary Enterprise during the benefits period. The uniform corporate tax rate was 9% in areas in Israel designated as Development Zone A and 16% elsewhere in Israel during 2015 and 2016, an amendment to the Investment law from December 2016 reduced the tax rate in Development Zone A to 7.5% starting from 2017 while the tax rate in other areas remains 16%.

In December 2016, the Economic Efficiency Law (Legislative Amendments for Applying the Economic Policy for the 2017 and 2018 Budget Years), 2016 which includes Amendment 73 to the Law for the Encouragement of Capital Investments ("the Amendment") was published. According to the Amendment, a preferred enterprise located in development area A will be subject to a tax rate of 7.5% instead of 9% effective from January 1, 2017 and thereafter (the tax rate applicable to preferred enterprises located in other areas remains at 16%).

A dividend distributed from income which is attributed to a Preferred Enterprise/Special Preferred Enterprise will be subject to withholding tax at source at the following rates: (i) Israeli resident corporation – 0%, (ii) Israeli resident individual – 20% as of 2014 and thereafter (iii) non-Israeli resident - 20% as of 2014 and thereafter subject to a reduced tax rate under the provisions of an applicable double tax treaty.

In December 2016 new legislation amended the Investment Law (the "2016 Amendment"). Under the 2016 Amendment a new status of "Technological Preferred Enterprise" was introduced to the Investment Law. Under the 2016 amendment, a Technological Preferred Enterprise which is located in areas other than Development Zone A will be subject to tax at a rate of 12% on profits derived from intellectual property. The implementation of the 2016 Amendment is subject to regulations to be promulgated by the Finance Minister by March 31, 2017. As such regulations have not yet been promulgated and as the definitive criteria to determine the tax benefits have not yet been established, it cannot be concluded that the legislation with respect to Technological Preferred Enterprises had been enacted or substantively enacted as of that date. Accordingly, the above changes in the tax rates were not taken into account in the computation of deferred taxes as of December 31, 2016. Under the transition provisions of the new legislation, the Company may decide to irrevocably implement the new law while waiving benefits provided under the current law or to remain subject to the current law.



ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 13:- TAXES ON INCOME (Cont.)

## d. Tax benefits under the law for the Encouragement of Industry (Taxes), 1969 (the "Encouragement Law"):

The Encouragement Law, provides several tax benefits for industrial companies. An industrial company is defined as a company resident in Israel, at least 90% of the income of which in a given tax year exclusive of income from specified 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.

Management believes that the Company is currently qualified as an "industrial company" under the Encouragement Law and as such, enjoys tax benefits, including: (1) deduction of purchase of know-how and patents and/or right to use a patent over an eight-year period; (2) the right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies and an industrial holding company; (3) accelerated depreciation rates on equipment and buildings; and (4) expenses related to a public offering on the Tel-Aviv Stock Exchange and on recognized stock markets outside of Israel, are deductible in equal amounts over three years.

Eligibility for benefits under the Encouragement Law is not subject to receipt of prior approval from any governmental authority. No assurance can be given that the Israeli tax authorities will agree that the Company qualifies, or, if the Company qualifies, then the Company will continue to qualify as an industrial company or that the benefits described above will be available to the Company in the future.

## e. Pre-tax income (loss) is comprised as follows:

	Year ended December 31,		
	2016	2015	2014
Domestic	\$(7,033)	\$(16,898)	\$(3,792)
Foreign	1,243	412	1,345
	\$(5,790)	\$(16,486)	\$(2,447)

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## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 13:- TAXES ON INCOME (Cont.)

f. A reconciliation of the theoretical tax expenses, assuming all income is taxed at the statutory tax rate applicable to the income of the Company and the actual tax expenses is as follows:

	Year ended December 31,		
	2016	2015	2014
Loss before taxes on income	\$(5,790)	\$(16,486)	\$(2,447)
Theoretical tax expense computed at the Israeli statutory tax rate (25%, 26.5% and 26.5% for the years 2016, 2015 and 2014, respectively)	\$(1,448)	\$(4,369 )	\$(649 )
Changes in valuation allowance	(469 )	3,716	(1,328)
Increase (decrease) in losses and temporary differences due to change in Israeli corporate and "Approved Enterprise" tax	(216 )	679	611
Write off of prepaid and withholding taxes	1,759	1,150	-
Foreign tax rates differences related to subsidiaries	576	103	(34 )
Non-deductible expenses and other	567	181	(381 )
Non-deductible share-based compensation expense	1,435	1,896	1,831
Actual tax expense	\$2,204	\$3,356	\$50

g. Income tax expense is comprised as follows:

	Year ended December 31,		
	2016	2015	2014
Current taxes	\$ 203	\$ 146	\$ 612
Deferred taxes (benefit)	242	2,060	(562 )
Write off of prepaid and withholding taxes	1,759	1,150	-
	\$ 2,204	\$ 3,356	\$ 50

ALLOT COMMUNICATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 13:- TAXES ON INCOME (Cont.)

h. Net operating losses carry forward:

The Company has accumulated net operating losses for tax purposes as of December 31, 2016, in the amount of approximately \$ 46,600, which may be carried forward and offset against taxable income in the future for an indefinite period. In December 2014, the Israeli Tax Authorities approved a final tax ruling with respect to the Company's acquisition of Oversi. According to the ruling, the net operating losses may be offset against taxable income annually with a limitation of up to 14% of the total accumulated losses but no more than 50% of the Company's taxable income. As of December 31, 2016, the Company recorded a full valuation allowance with respect to its deferred tax assets in Allot Communications Ltd. and wrote-off prepaid and withholding taxes of \$ 1,759 as the Company does not expect to utilize these tax assets in the near future. In addition, the Company has accumulated capital losses for tax purposes as of December 31, 2016, of approximately \$ 27,300, which may be carried forward and offset against taxable capital gains in the future for an indefinite period, but are limited as stated above. Management currently believes that since the Company has a history of losses, and uncertainty with respect to future taxable income, it is more likely than not that the deferred tax assets regarding the loss carry forwards will not be utilized in the foreseeable future. Thus, a valuation allowance was provided to reduce deferred tax assets to their realizable value.

The U.S. subsidiary has accumulated losses for U.S. federal income tax return purposes of approximately \$ 5,517. The federal accumulated losses for tax purposes expire between 2026 and 2032. The state accumulated losses for tax purposes began to expire in 2014. An amount of \$ 1,707 of the net operating loss carry-forwards relates to excess tax deductions from stock options.

Such losses are subject to limitations of Internal Revenue Code, Section 382, which in general provides that utilization of net operating losses is subject to an annual limitation if an ownership change results from transactions increasing the ownership of certain shareholders or public groups in the stock of a corporation by more than 50 percentage points over a three-year period. The annual limitations may result in the expiration of losses before utilization.

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## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 13:- TAXES ON INCOME (Cont.)

- i. Deferred income taxes:

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

	December 31,	
	2016	2015
Deferred tax assets:		
Operating and capital loss carryforwards	\$12,900	\$14,842
Reserves and allowances	2,022	948
Deferred tax asset before valuation allowance	14,922	15,790
Valuation allowance	(14,655)	(15,124)
Net deferred tax asset	267	666
Deferred tax liability	-	(157 )
Net deferred tax asset	\$267	\$509

As of December 31, 2016, the provision in respect of ASC 740-10 was immaterial. As of December 31, 2015, the Company recorded a provision in the amount of \$293. The accrued interest and penalties related to the provision in income taxes is immaterial.

The Company conducts business globally and, as a result, the Company or one or more of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as Israel, France, and the United States. With a few exceptions, the Company is no longer subject to Israeli tax assessment through the year 2012 and the European and U.S. subsidiaries have final tax assessments through 2012.

## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 14:- GEOGRAPHIC INFORMATION

Allot operates in a single reportable segment. Revenues are based on the location of the Company's channel partners which are considered as end customers, as well as direct customers of the Company:

	Year ended December 31,		
	2016	2015	2014
Europe	\$34,279	\$39,110	\$41,238
Asia and Oceania	27,700	28,495	41,990
Americas (excluding the United States)	13,094	14,347	3,299
Middle East and Africa	12,365	9,809	15,352
United States	2,931	8,206	15,307
	\$90,369	\$99,967	\$117,186

The following are the Company's major customers:

	Year ended December 31,		
	2016	2015	2014
Customer A	25 %	27 %	27 %
Customer B	17 %	-	-
Customer C	-	10 %	17 %
	42 %	37 %	44 %

The following presents total long-lived assets as of December 31, 2016 and 2015:

	December 31,	
	2016	2015
Long-lived assets:		
Israel	\$4,156	\$4,924
United States	42	109
Other	189	156
	\$4,387	\$5,189



## ALLOT COMMUNICATIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 15:- FINANCIAL INCOME (EXPENSES), NET

	Year ended December 31,		
	2016	2015	2014
Financial income:			
Interest income	\$2,466	\$2,174	\$1,900
Financial expenses:			
Exchange rate differences and other	186	1,480	174
Amortization/accretion of premium/discount on marketable securities, net	1,221	1,278	1,066
	\$1,059	\$(584)	\$660

## NOTE 16:- EARNINGS PER SHARE

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

	Year ended December 31,		
	2016	2015	2014
Numerator:			
Net loss	\$(7,994)	\$(19,842)	\$(2,497)
Denominator:			
Weighted average number of shares outstanding used in computing diluted net loss per share	33,202,309	33,419,917	33,143,168
Basic and diluted net loss per share	\$(0.24)	\$(0.59)	\$(0.08)

The following numbers of shares were excluded from the computation of diluted net loss per ordinary share for the periods presented because including them would have had an anti-dilutive effect:

	Year ended December 31,		
	2016	2015	2014
Ordinary shares	2,000,757	3,424,891	2,300,425