

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

FORM 20 – F

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

OR

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from _____ to _____

Commission file number 0-30070

AUDICODES LTD.

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

ISRAEL

(Jurisdiction of incorporation or organization)

1 Hayarden Street, Airport City Lod 70151, Israel

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
None	

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

Ordinary Shares, nominal value NIS 0.01 per share

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2004, the Registrant had outstanding 39,865,993 Ordinary Shares, nominal value NIS 0.01 per share.

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 which financial statement item the registrant has elected to follow.

Item 17 Item 18

PART I

Unless the context otherwise requires, "AudioCodes," "us," "we" and "our" refer to AudioCodes Ltd. and its subsidiaries.

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

We derived the consolidated statements of operations data for the years ended December 31, 2002, 2003 and 2004 and consolidated balance sheets data as of December 31, 2003 and 2004 from the audited consolidated financial statements set forth elsewhere in this Annual Report. We derived the consolidated statements of operations data for the years ended December 31, 2000 and 2001 and the consolidated balance sheets data as of December 31, 2000, 2001 and 2002 from audited consolidated financial statements that are not included in this Annual Report.

On October 6, 2000, we effected a two-for-one stock split in the form of a stock dividend. All share and per share data for periods prior to and including that date have been retroactively adjusted to reflect this stock split. All figures relating to outstanding shares exclude shares held in treasury.

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

	Year Ended December 31,				
	2000	2001	2002	2003	2004
Statement of Operations Data:					
Revenues	\$ 71,798	\$ 35,734	\$ 27,189	\$ 44,228	\$ 82,756
Cost of revenues	28,029	21,942	13,006	20,037	34,375
Gross profit	43,769	13,792	14,183	24,191	48,381
Operating expense:					
Research and development, net	10,588	13,807	13,022	15,476	20,009
Selling and marketing	11,204	13,852	14,288	14,537	19,891
General and administrative	2,917	5,044	3,353	4,066	4,851
Total operating expenses	24,709	32,703	30,663	34,079	44,751
Operating income (loss)	19,060	(18,911)	(16,480)	(9,888)	3,630
Financial income, net	8,057	6,388	2,623	1,883	2165
Equity in losses of an affiliated company	-	750	300	429	516
Income (loss) before taxes on income	27,117	(13,273)	(14,157)	(8,434)	5,279
Taxes on income	438	-	-	-	273
Net income (loss)	\$ 26,679	\$ (13,273)	\$ (14,157)	\$ (8,434)	\$ 5,006
Basic net earnings (loss) per share	\$ 0.68	\$ (0.34)	\$ (0.37)	\$ (0.22)	\$ 0.13
Diluted net earnings (loss) per share	\$ 0.62	\$ (0.34)	\$ (0.37)	\$ (0.22)	\$ 0.12
Weighted average number of ordinary of shares used in computing basic net earnings (loss) per share	39,273	39,591	38,518	37,509	38,614
Weighted average number of ordinary shares used in computing diluted net earnings per share	43,051	39,591	38,518	37,509	42,607

	December 31,				
	2000	2001	2002	2003	2004
Balance Sheet Data:					
Cash and cash equivalents	\$ 9,575	\$ 50,086	\$ 47,799	\$ 48,898	\$ 166,832
Short-term bank deposits	135,598	79,984	63,074	-	-
Working capital	146,119	126,242	108,370	46,232	171,447
Long-term bank deposits and structured notes	-	-	-	50,270	50,195
Total assets	174,329	148,416	129,814	128,530	272,145
Senior convertible notes	-	-	-	-	120,660
Total shareholders' equity	149,720	131,255	113,384	106,518	121,985

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

We are subject to various risks and uncertainties relating to or arising out of the nature of our business and general business, economic, financing, legal and other factors or conditions that may affect us. We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition, cash flows and results of operations.

Risks Related to Our Business and Industry

The slowdown in capital expenditures by telecommunications service providers has had and could continue to have a material adverse effect on our results of operations.

A deterioration of economies around the world and economic uncertainty in the telecommunications market began in 2000 and continued through 2003. This resulted in a curtailment of capital investment by telecommunications carriers and service providers as well as by businesses that use our products, referred to as the enterprise market. It also reduced our ability to forecast orders, also referred to as "low visibility". We cannot be sure whether increased expenditures will continue to be made in the telecommunications industry in general or in the voice over packet portion of the market. The decline in capital expenditures has in the past had a substantial impact on our results of operations with our revenues declining from \$71.8 million in 2000 to \$27.2 million in 2002 primarily as a result of such a decline. Because a substantial portion of our operating expenses consist of salaries, we may not be able to reduce our operating expenses in line with any reduction in revenues or may elect not to do so for business reasons. As a result of this downturn and our relatively stable operating expenses, we incurred a net loss of \$13.3 million in 2001, \$14.2 million in 2002 and \$8.4 million in 2003. We will need to continue to generate increased revenues as well as manage our costs to maintain profitability. Any future industry downturn may increase our inventories, decrease our revenues, result in additional pressure on the price of our products and prolong the time until we are paid, all of which would have a material adverse effect on the results of our operations and on our cash flow from operations.

If new products we recently introduced or expect to introduce in the near future fail to generate the level of demand we originally anticipated, we will realize a lower than expected return from our investment in research and development with respect to those products, and our results of operations may suffer.

Our success is dependent, in part, on the willingness of our customers to transition or migrate to new products, such as our expanded offering of Mediant and Stretto systems, or expected future products. We are involved in a continuous process of evaluating changing market demands and customer requirements in order to develop and introduce new products, features and applications to meet changing demands and requirements. We need to be able to interpret market trends and the advancement of technology in order to successfully develop and introduce new products, features and applications. If potential customers defer transition or migration to new products, our return on our investment in research and development with respect to products recently introduced or expected to be introduced in the near future will be lower than we originally anticipated and our results of our operations may suffer.

Our industry is rapidly evolving and we may not be able to keep pace with technological changes, which could adversely affect our business.

The transmission of voice, data and fax over data networks is rapidly evolving. Short product life cycles place a premium on our ability to manage the transition from current products to new products. Our future success in generating revenues will depend on our ability to enhance our existing products and to develop and introduce new products and product features. These products and features must keep pace with technological developments and address the increasingly sophisticated needs of our customers. The development of new technologies and products is increasingly complex and uncertain. This increases the difficulty in coordinating the planning and production process and can result in delay in the introduction of new technologies and products.

We are dependent on the development of the VoP market to increase our sales.

The market for Voice over Packet, or VoP, services is currently developing. We cannot be sure that the delivery of telephone and other communications services over packet networks rather than over traditional telephone networks will expand. We cannot be sure that packet based voice networks will become widespread or that connections between packet networks and telephone networks will become commonplace. The adaptation process of connecting packet networks and telephone networks can be time consuming and costly. In addition, limitations of VoP technology, such as the inability to make a call during a power outage and difficulty in accessing 911 services, could adversely affect the market for VoP services. Sales of our VoP products will depend on the development of packet networks and the commercialization of VoP services. If this market does not develop, or develops more slowly than we expect, we may not be able to sell our products in significant volume.

New industry standards, the modification of our products to meet additional existing standards or the addition of features to our products may delay the introduction of our products or increase our costs.

The industry standards that apply to our products are continually evolving. In addition, since our products are integrated into networks consisting of elements manufactured by various companies, they must comply with a number of industry standards and practices established by various international bodies and industry forums. Should new standards gain broad acceptance, we will be required to adopt those standards in our products. We may also decide to modify our products to meet additional existing standards or add features to our products. Standards may be adopted by various industry interest groups or may be proprietary and nonetheless accepted broadly in the industry. It may take us a significant amount of time to develop and design products incorporating these new standards. We may also have to pay additional fees to the developers of the technologies which constitute the newly adopted standards.

Our customers or potential customers may develop or prefer to develop their own technical solutions, and as a result, would not buy our products.

Our products are primarily sold as components or building blocks to large original equipment manufacturers, or OEM's, or network equipment providers. Our customers incorporate our products into their product offerings, usually in conjunction with value-added services of their own or of third parties. Customers or potential customers may prefer to develop their own technology or purchase third party technology. They could also manufacture their own components or building blocks that are similar to the ones we offer. Large customers have already committed significant resources in developing integrated product offerings. Customers may decide that this gives them greater control over supplies, specifications and performance. Customers may therefore not buy components from an external manufacturer such as us. This could have an adverse impact on our ability to sell our products and our revenues.

We have depended on a small number of large customers. The loss of one of these customers or the reduction in purchases by a significant customer could have a material adverse effect on our revenue.

Historically, a substantial portion of our revenue has been derived from large purchases by a small number of OEMs and network equipment providers, systems integrators and distributors. For example, our top three customers accounted for approximately 29.0% of our revenues in 2004, 26.9% of our revenues in 2003 and 22.4% of our revenues in 2002. Sales to Nortel Networks accounted for 18.6% of our revenues in 2004 compared to 14.3% of our revenues in 2003 and 1.4% of our revenues in 2002. We do not enter into sales agreements in which the customer is obligated to purchase a set quantity of our products. Based on our experience, we expect that our customer base may change from period to period. If we lose a large customer and fail to add new customers there could be a material adverse effect on our results of operations.

Our quarterly results of operations have fluctuated in the past and we expect these fluctuations to continue. Fluctuations in our results of operations may disappoint investors and result in a decline in our share price.

We have experienced and expect to continue to experience significant fluctuations in our quarterly results of operations. In some periods, our operating results may be below public expectations. If this occurs, the market price of our ordinary shares could decline.

The following factors have affected our quarterly results of operations in the past and are likely to affect our quarterly results of operations in the future:

- size, timing and pricing of orders, including order deferrals and delayed shipments;
- launching of new product generations;
- length of approval processes or market testing;
- technological changes in the telecommunications industry;

- competitive pricing pressures;
- the timing and approval of government research and development grants;
- accuracy of telephone company, distributor and original equipment manufacturer forecasts of their customers' demands;
- changes in our operating expenses;
- disruption in our sources of supply; and
- general economic conditions.

Therefore, the results of any past periods may not be relied upon as an indication of our future performance.

We have a limited order backlog. If revenue levels for any quarter fall below our expectations, our results of operations will be adversely affected.

We have a limited order backlog, which makes revenues in any quarter substantially dependent on orders received and delivered in that quarter. A delay in the recognition of revenue, even from one customer, may have a significant negative impact on our results of operations for a given period. We base our decisions regarding our operating expenses on anticipated revenue trends, and our expense levels are relatively fixed, or require some time for adjustment. Because only a small portion of our expenses varies with our revenues, if revenue levels fall below our expectations, our results of operations will be adversely affected.

Generally, we sell to original equipment manufacturers, or OEMs, network equipment providers or system integrator customers, as well as to distributors. As a result, we have less information with respect to the actual requirements of end users and their utilization of equipment. We also have less influence over the choice of equipment by these end users.

We typically sell to OEM customers, network equipment providers, and system integrators, as well as to distributors. Our customers usually purchase equipment from several suppliers and may be trying to fulfill one of their customers' specific technical specifications. We rely heavily on our customers for sales of our products and to inform us about market trends and the needs of their customers. We cannot be certain that this information is accurate. If the information we receive is not accurate, we may be manufacturing products that do not have a customer or fail to manufacture products that end users want. Because we are selling products to OEMs, system integrators and distributors rather than directly to end users, we have less control over the ultimate selection of products by end users.

The markets we serve are highly competitive and many of our competitors have much greater resources, which may make it difficult for us to maintain profitability.

Competition in our industry is intense and we expect competition to increase in the future. Our competitors currently sell products that provide similar benefits to those that we sell.

Our principal competitors in the sale of signal processing chips are Texas Instruments, Broadcom Infineon, Centillium, Mindspeed, Netergy and VoicePump, a subsidiary of DSP Group. Several large manufacturers of generic signal processors, such as Motorola, Agere Systems and Intel have begun, or are expected to begin market competing processors. Competition for our module level products include semiconductor manufacturers such as Texas Instruments, Mindspeed, Centillium, Performance Technologies Inc., and Spectrum Signal Processing Inc. Our principal competitors in the communications board market are NMS Communications, Intel, Motorola, Brooktrout, Inc., Acculab and PIKA Technologies, Inc.

Our principal competitors in the area of analog media gateways (2 to 24 ports) for access and enterprise are Cisco Systems Inc., Mediatrix Telecom, Inc., Vega Stream Limited, Samsung, Innovaphone AG, Quintum Technologies, Tainet Communication System Corp., Welltech, Ascii Corp., D-Link Systems, Inc., Multitech Inc., Inomedia, OKE LG, Cisco Systems, Veraz Networks, Sonus Networks, Nuera, Tekelec, General Bandwidth, Telica and Commatch. In addition we face competition in mid and high density gateways from internal development at companies such as Nortel, Lucent, Alcatel, Siemens, Huawei, UTstarcom, ZTE and others.

We also face significant and increasing competition in the market for products utilized in the VoIP market. Our competitors in the market for VoIP products include telecommunications companies, data communication companies and companies specializing in voice over IP products, some of which have greater name recognition, larger installed customer bases and significantly greater financial, technical and marketing resources than we do.

Many of our competitors have the ability to offer vendor-sponsored financing programs to prospective customers. Some of our competitors with broad product portfolios may also be able to offer lower prices on products that compete with ours because of their ability to recoup a loss of margin through sales of other products or services. Additionally, voice, audio and other communications alternatives that compete with our products are being continually introduced.

In the future, we may also develop and introduce other products with new or additional telecommunications capabilities or services. As a result, we may compete directly with telephone companies and other telecommunications infrastructure providers. Additional competitors may include companies that currently provide computer software products and services, such as telephone, media, publishing and cable television. The ability of some of our competitors to bundle other enhanced services or other products, such as video images, with VoIP products could give these competitors an advantage over us.

Offering to sell system level products that compete with the products manufactured by our customers could negatively affect our business.

We have broadened our product offerings from chips to boards, subsystems and gateway level products (systems). These products could compete with products offered by our customers. These customers could decide to decrease purchases from us because of this competition. This could result in a material adverse effect on our results of operations.

We rely on third-party subcontractors to assemble our products and therefore do not directly control manufacturing costs, product delivery schedules or manufacturing quality.

Our products are assembled and tested by third-party subcontractors. As a result of our reliance on third-party subcontractors, we cannot directly control product delivery schedules. We have in the past experienced delays in delivery schedules. Any problems that occur and persist in connection with the delivery, quality or cost of the assembly and testing of our products could have a material adverse effect on our business, financial condition and results of operations. This reliance could also lead to product shortages or quality assurance problems, which, in turn, could lead to an increase in the costs of manufacturing or assembling our products.

We may not be able to deliver our products to our customers, and substantial reengineering costs may be incurred if a small number of third-party suppliers do not provide us with key components on a timely basis.

Texas Instruments Incorporated supplies all of the chips for our signal processor product line. Our signal processor line is used both as a product line in its own right and as a key component in our other product lines. Motorola manufactures all of the communications processors currently used on our communications boards. These suppliers also supply many of our competitors.

We have not entered into any long-term supply agreements or alternate source agreements with our suppliers and, while we maintain an inventory of critical components, our inventory of chips would likely not be sufficient in the event that we had to engage an alternate supplier for these components.

Texas Instruments is also one of our major competitors in providing signal processing solutions. An unexpected termination of the supply of the chips provided by Texas Instruments or Motorola or disruption in their timely delivery, would require us to make a large investment in capital and manpower resources to shift to using signal processors manufactured by other companies and may cause a delay in introducing replacement products. Customers may not accept an alternative product design. Supporting old products or redesigning products may make it more difficult for us to support our products.

We utilize other sole source suppliers upon whom we depend without having long term supply agreements.

Some of our sole source suppliers custom produce components for us based upon our specifications and designs while other of our sole source suppliers are the only manufacturers of certain components required by our products. We have not entered into any long-term supply agreements or alternative source agreements with our suppliers and while we maintain an inventory of components from single source providers, our inventory would likely not be sufficient in the event that we had to engage an alternate supplier of these single source components. In the event of any interruption in the supply of components from any of our sole source suppliers, we may have to expend significant time, effort and other resources in order to locate a suitable alternative manufacturer and secure replacement components. If no replacement components are available, we may be forced to redesign certain of our products. Any such new design may not be accepted by our customers. A prolonged disruption in supply may force us to redesign and retest our products. Any interruption in supply from any of these sources or an unexpected technical failure or termination of the manufacture of components could disrupt production, thereby adversely affecting our ability to deliver products and to support products previously sold to our customers.

In addition, if demand for telecommunications equipment increases, we may face a shortage of components from our suppliers. This could result in longer lead times, increases in the price of components and a reduction in our margins, all of which could adversely affect the results of our operations.

Our customers may require us to produce products or systems to hold in inventory in order to meet their “just in time”, or short lead time, delivery requirements. If we are unable to sell this inventory on a timely basis, we could incur charges for excess and obsolete inventory which would adversely affect our results of operations.

Our customers expect us to maintain an inventory of products available for purchase off the shelf subsequent to the initial sales cycle for these products. This may require us to incur the costs of manufacturing inventory without having a purchase order for the products. The VoP industry is subject to rapid technological change and volatile customer demands, which result in a short product commercial life before a product becomes obsolete. If we are unable to sell products that are produced to hold in inventory, we may incur write offs and write downs as a result of slow moving items, technological obsolescence, excess inventories, discontinued products and products with market prices lower than cost. Write offs and write downs could adversely affect our operating results and financial condition. We wrote off and wrote down inventory in the amount of \$1.7 million in 2002, \$835,000 in 2003 and \$1.2 million in 2004.

Our products generally have long sales cycles and implementation periods, which increase our costs in obtaining orders and reduce the predictability of our revenues.

Our products are technologically complex and are typically intended for use in applications that may be critical to the business of our customers. Prospective customers generally must make a significant commitment of resources to test and evaluate our products and to integrate them into larger systems. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. The sales cycles of our products to new customers are approximately six to twelve months after a design win, depending on the type of customer and complexity of the product. This time may be further extended because of internal testing, field trials and requests for the addition or customization of features. This delays the time until we realize revenue and results in our investing significant resources in attempting to make sales.

Long sales cycles also subject us to risks not usually encountered in a short sales span, including customers’ budgetary constraints, internal acceptance reviews and cancellation. In addition, orders expected in one quarter could shift to another because of the timing of customers’ procurement decisions. The time required to implement our products can vary significantly with the needs of our customers and generally exceeds several months; larger implementations can take multiple calendar quarters. This complicates our planning processes and reduces the predictability of our revenues.

Our proprietary technology is difficult to protect, and our products may infringe on the intellectual property rights of third parties. Our business may suffer if we are unable to protect our intellectual property or we are sued for infringing the intellectual property rights of third parties.

Our success and ability to compete depend in part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement, or to protect us from the claims of others. Enforcement of intellectual property rights may be expensive and may divert attention of management and of research and development personnel away from our business. Intellectual property litigation could also call into question the ownership or scope of rights owned by us. We believe that at least one of our patents may cover technology related to the ITU G.723.1 standard. Because of our involvement in the standard setting process, we may be required to license certain of our patents on a reasonable and non-discriminatory basis to a current or future competitor, to the extent required to carry out the G.723.1 standard. Additionally, our products may be manufactured, sold, or used in countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws or where we do not hold relevant intellectual property rights.

Any intellectual property claims against us, even without merit, could cost us a significant amount of money to defend and divert management's attention away from our business. We may not be able to get a license for technology that is used in our products and we may face injunctive proceedings that prevent distribution and sale of our products even prior to any dispute being concluded. These proceedings may also have a deterrent effect on purchases by customers, who may be unsure about our ability to continue to supply their requirements. We may be forced to repurchase our products and compensate customers that have purchased such infringing products. We may be forced to redesign the product so that it becomes non-infringing, which may have an adverse impact on the results of our operations.

Multiple patent holders in our industry may result in increased licensing costs.

There are a number of companies besides us that hold patents for various aspects of the technology incorporated in our industry's standards and our products. We expect that patent enforcement will be given high priority by companies seeking to gain competitive advantages or additional revenues. The holders of patents from which we have not obtained licenses may take the position that we are required to obtain a license from them. We cannot be certain that we would be able to negotiate a license agreement at an acceptable price or at all. Our results of operations could be adversely affected by the payment of any additional licensing costs or if we are prevented from manufacturing or selling a product.

Changes in governmental regulations in the United States or other countries could slow the growth of the VoIP telephony market and reduce the demand for our customers' products, which, in turn, could reduce the demand for our products.

In the United States, changes in governmental regulation are being considered that may negatively impact the VoIP telephony market. For example, the Federal Communications Commission (FCC) has to date treated providers of telephone services over the public Internet as "enhanced service providers". Enhanced service providers are currently exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. The FCC is examining the enactment of new regulations governing Internet telephony and the question of whether certain forms of telephone services over the Internet should be subject to the same FCC regulations as telecommunications services.

VoIP equipment can be used as a way to provide telecommunication services while bypassing the local service operator, in what is sometime referred to as "toll bypass". Telecommunications traffic is diverted from traditional telephone lines to the public Internet, thus avoiding long distance call charges. As the use of VoIP to provide telecommunication services increases, phone companies are seeking the adoption of regulations that would require providers or users of such diverted calls to pay a charge to local service providers.

On March 10, 2004, the FCC released a Notice of Proposed Rule Making that seeks to establish a regulatory framework for Internet Protocol-Enabled Services, including VoIP services. The Notice of Proposed Rule Making seeks comments on how various IP-enabled services, including VoIP, should be differentiated for regulatory purposes, and whether there are technical or other characteristics of particular VoIP services that warrant differential regulatory treatment. When the FCC enacts new regulations governing VoIP, or if it determines that certain telephony providers over the public Internet, or the services they provide, are subject to current FCC regulations governing common carriers, then some of the service providers that buy equipment from our customers may be forced to pay access charges and make universal service contributions, or may be subject to other taxes, fees or restrictions under any such new regulations. The required payment of additional taxes, fees or charges for VoIP services may impact the profitability of these services and the use of VoIP services or technology.

On May 19, 2005, the FCC issued an order that requires interconnected VoIP service providers to be able to deliver all 911 calls to the customer's local emergency operator. Interconnected providers are those companies that enable VoIP customers to receive calls from and make calls to the traditional public switched telephone network. The FCC also indicated that it would adopt rules in the future that would require a method for determining the location of a VoIP customer making a 911 call without the customer having to report this information. VoIP service providers may have difficulties complying with this order in the required time frame, as well as any future orders issued by the FCC. Equipment and software manufacturers may have difficulty in complying with new technical requirements. In addition, the cost of providing Internet phone service could increase which could result in slower growth and decreased profitabilities for this industry. The increase in regulation of VoIP services and the increase in the cost of these services could adversely affect sales of our products and adversely affect our results of operations.

The enactment of any additional regulation or taxation of communications over the public Internet in the United States or elsewhere in the world could have a material adverse effect on our customers' (and their customers') businesses and could therefore adversely affect sales of our products. We do not know what effect, if any, possible legislation or regulatory actions in the United States or elsewhere in the world may have on private telecommunication networks, the provision of VoIP services and purchases of our products.

Use of encryption technology in our products is regulated by governmental authorities and may require special development, export or import licenses. Delays in the issuance of required licenses, or the inability to secure these licenses, could adversely affect our revenues and results of operations.

Growth in the demand for security features may increase the use of encryption technology in our products. The use of encryption technology is generally regulated by governmental authorities and may require specific development, export or import licenses. Encryption standards may be based on proprietary technologies. We may be unable to incorporate encryption standards into our products in a manner that will insure interoperability. We also may be unable to secure licenses for proprietary technology on reasonable terms. If we cannot meet encryption standards, or secure required licenses for proprietary encryption technology, our revenues and results of operations could be adversely affected.

A significant portion of our revenues is generated outside of the U.S. and Israel and we intend to continue to expand our operations internationally and therefore our results of operations could suffer if we are unable to manage our international operations effectively.

We generated 36% of our revenues in 2003 and 28% of our revenues in 2004 outside of the United States and Israel. Part of our strategy is to expand our penetration in existing foreign markets and to enter new foreign markets. Our ability to penetrate some international markets may be limited due to different technical standards, protocols or product requirements in different markets. Expansion of our international business will require significant management attention and financial resources. Our international sales and operations are subject to numerous risks inherent in international business activities, including:

- economic and political instability in foreign countries;
- staffing and managing foreign operations;
- increased risk of collection; and
- burdens that may be imposed by tariffs and other trade barriers.

If we are unable to address these risks, our foreign operations may be unprofitable or the value of our investment in our foreign operations may decrease.

Currently, our international sales are denominated primarily in dollars. Therefore, any devaluation in the local currencies of our customers relative to the dollar could cause customers to decrease or cancel orders or default on payment.

The prices of our products may become less competitive due to foreign exchange fluctuations.

Foreign currency fluctuations may affect the prices of our products. Our prices in all countries are denominated primarily in dollars. If there is a significant devaluation in a specific country, the prices of our products will increase relative to the local currency and may be less competitive. We cannot be sure that our international customers will continue to place orders denominated in dollars. The introduction into circulation of the Euro in 2002 placed pressure on us to sell to European customers in Euro rather than dollar prices. Sales denominated in Euros could make our revenues subject to fluctuation in the Euro/dollar exchange rate.

We may be unable to attract sales representatives who will market our products effectively.

A significant portion of our marketing and sales involves the aid of independent sales representatives that are not under our direct control. We cannot be certain that our current independent sales representatives will continue to distribute our products or that, even if they continue to distribute our products, they will do so successfully. These representatives are not subject to any minimum purchase requirements and can discontinue marketing our products at any time. In addition, these representatives often market products of our competitors. Accordingly, we must compete for the attention and sales efforts of our independent sales representatives.

Our products could contain defects, which would reduce sales of those products or result in claims against us.

We develop complex and evolving products. Despite testing by us and our customers, undetected errors or defects may be found in existing or new products. The introduction of products with reliability, quality or compatibility problems could result in reduced revenues, additional costs, increased product returns and difficulty or delays in collecting accounts receivable. The risk is higher with products still in the development stage, where full testing or certification is not yet completed. This could result in, among other things, a delay in recognition or loss of revenues, loss of market share or failure to achieve market acceptance. We could also be subject to material claims by customers that are not covered by our insurance.

Obtaining certification of our products by national regulators may be time-consuming and expensive. We may be unable to sell our products in markets in which we are unable to obtain certification.

Our customers may expect us to obtain certificates of compliance with safety and technical standards set by national regulators, especially standards set by U.S. or European regulators. There is no uniform set of standards, and each national regulator may impose and change its own standards. National regulators may also prohibit us from importing products that do not conform to their standards. If we make any change in the design of a product, we are usually required to obtain recertification of the product. The process of certification may be time-consuming and expensive and may affect the length of the sales cycle for a product. If we are unable to obtain certification of a product in a market, we may be unable to sell the product in that market.

We depend on a limited number of key personnel who would be difficult to replace.

Because our products are complex and our market is evolving, the success of our business depends in large part upon the continuing contributions of our management and key personnel. Specifically, we rely heavily on the services of Shabtai Adlersberg, our Chief Executive Officer. If Shabtai Adlersberg is unable or unwilling to continue with us, our results of operations could be materially and adversely affected. We do not carry key person insurance for Mr. Adlersberg.

The success of our business also depends upon our continuing ability to attract and retain other highly-qualified management, technical, sales and marketing personnel. We need highly-qualified technical personnel who are capable of developing technologies and products and providing the technical support required by our customers. Such personnel were and may again be in great demand and we may not be successful in attracting, integrating or retaining them when and as required.

We intend to expand our business 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 pursue acquisitions of, or investments in, businesses and technologies or to establish joint ventures to expand our business. For example, in April 2003, we purchased a product group from Nortel Networks and in May 2004 we purchased Ai-Logix Inc. We also increased our holdings in a privately held speech-recognition company during 2003. We recognized losses from this investment in our results of operations in each of the past three years.

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. If any acquisition, investment or joint venture were to occur, we may not realize the intended benefits of the acquisition, investment or joint venture and we may incur future losses from such acquisition, investment or joint venture.

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;
- amortization of intangibles and potential impairment of goodwill; and
- write-offs of in-process research and development.

If acquisitions disrupt our operations, our business may suffer.

If we do not manage our anticipated growth effectively, our results of operations could be adversely affected.

We have actively expanded our operations in the past and may continue to expand them in the future. This expansion has required, and may continue to require, the application of managerial, operational and financial resources. We cannot be sure that we will continue to expand, or that we will be able to expand our operations successfully. In particular, our business requires us to focus on multiple markets, including the VoIP, cable and wireless markets. In addition, we work simultaneously with a number of large OEMs and network equipment providers each of which may have different requirements for the products that we sell to them. We may not have sufficient manpower, or may be unable to devote this manpower when needed, to address the requirements of these markets and customers. If we are unable to manage our expanding operations effectively, our revenues may not increase, our cost of operations may rise and our results of operations may be adversely affected.

As we grow we may need new or enhanced systems, procedures or controls. The transition to such systems, procedures or controls, as well as any delay in transitioning to new or enhanced systems, procedures or controls, may seriously harm our ability to accurately forecast sales demand, manage our product inventory and record and report financial and management information on a timely and accurate basis.

We may not be able to raise additional financing for our future capital needs on favorable terms, or at all, which could limit our ability to grow and to continue our longer term expansion plans.

We may need to raise additional capital in the future to continue our longer term expansion plans. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms, or at all. This could inhibit our growth and increase our financing costs.

We extend credit to customers for purchases of our products. We could incur charges in our statement of operations if we are unable to collect these accounts receivable.

A portion of our receivables result from credit extended to customers for purchases of our products. We cannot be sure that we will be able to collect all of these accounts receivable. The failure to collect accounts receivable could adversely affect our cash flow position and results of operations.

Our gross profit percentage could be negatively impacted by increased manufacturing costs and other factors. This could adversely affect our results of operations.

Our gross profit percentage has increased in each of the past three years. However, our gross profit percentage is still lower than in 2000. The recent increase in our gross profit percentage could be negatively affected by an increase in manufacturing costs, a shift in our sales mix towards our less profitable products, increased customer demand for longer product warranties and increased cost pressures as a result of increased competition. Acquisitions of new businesses could also negatively affect our gross profit percentage, which could cause an adverse effect on our results of operations.

The growth in our product portfolio means that we have to service and support more products. This may result in an increase in our expenses and an adverse effect on our results of operations.

The size of our product portfolio has increased and continues to increase. As a result, we are required to provide to our customers sales support and maintenance. Customers have requested that we provide a contractual commitment to support a product for a specified period of time. This period of time may exceed the working life of the product or extend past the period of time that we may intend to manufacture or support a product. We are dependent on our suppliers for the components (hardware and software) needed to provide support and may be unable to secure the components necessary to satisfy our service commitments. We do not have long term contracts with our suppliers, and they may not be obligated to provide us with products or services for any specified period of time. We may need to purchase an inventory of replacement components and parts in advance in order to try to provide for their availability when needed. This could result in increased risk of write offs with respect to our replacement component inventory to the extent that we cannot accurately predict our future requirements under our customer service contracts. If any of our component suppliers cease production, cease operations or refuse or fail to make timely delivery of orders, we may not be able to meet our contractual commitments for product support or maintenance. We may be required to supply upgraded components or parts as substitutes if the original versions are no longer available. Product support may be costly and any extra service revenues may not cover the hardware and software costs associated with providing long-term support or maintenance.

Risks Relating to Operations in Israel

Conditions in Israel affect our operations and may limit our ability to produce and sell our products.

We are incorporated under the laws of the State of Israel, and our principal offices are located in the State of Israel. Political, economic and military conditions in Israel directly affect our operations. Terrorist attacks against Israel have greatly intensified since September 2000, which have led to ongoing hostilities between Israel, the Palestinian Authority and other groups in the West Bank and Gaza Strip. We cannot predict the effect on us of an increase in these hostilities or any future armed conflict, political instability or violence in the region. Some of our officers and employees in Israel are obligated to perform up to 36 days of military reserve duty annually and are subject to being called for additional active duty under emergency circumstances. We cannot predict the full impact of these conditions on us in the future, particularly if emergency circumstances occur. If many of our employees are called for active duty, our operations in Israel and our business may be adversely affected. Additionally, a number of countries continue to restrict or ban business with Israel or Israeli companies, which may limit our ability to make sales in those countries.

The Israeli rate of inflation may negatively impact our costs if it exceeds the rate of devaluation of the New Israeli Shekel against the U.S. dollar.

A substantial portion of the cost of our Israeli operations, mainly personnel and facility-related, is incurred in New Israeli Shekels (NIS). In 2004, approximately 37% of our costs were incurred in NIS. As a result, we bear the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israeli Shekel in relation to the dollar or that the timing of such devaluations were to lag considerably behind inflation, which will increase our costs as expressed in dollars.

To protect against the changes in value of forecasted foreign currency cash flows resulting from payments in NIS, we maintain a foreign currency cash flow hedging program. We hedge portions of our forecasted expenses denominated in foreign currencies with forward contracts. These measures may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

The Israeli government programs and tax benefits that we currently participate in, or receive, require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs.

We benefit from certain government programs and tax benefits, particularly as a result of exemptions and reductions resulting from the "approved enterprise" status of our existing production facilities and programs in Israel. To be eligible for these programs and tax benefits, we must continue to meet conditions, including making specified investments in fixed assets and financing a percentage of investments with share capital. If we fail to meet such conditions in the future, we will be subject to corporate tax at the rate then in effect under Israeli law for such tax year. A comprehensive amendment to the law prescribing these benefits has recently been approved by the Knesset. The amendment imposes additional eligibility criteria for approved enterprise benefits. The amendment also offers additional forms of alternative benefits. We do not believe that the amendment would have a material effect on us.

In 2004, we recognized a grant of \$765,000 from the Government of Israel, through the Office of the Chief Scientist, or the OCS, for the financing of a portion of our research and development expenditures in Israel. The OCS budget has been subject to reductions, which may affect the availability of funds for these prospective grants and other grants in the future. As a result, we cannot be certain that we will continue to receive grants at the same rate, or at all. In addition, the terms of any future OCS grants may be less favorable than our past grant.

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

In connection with research and development grants received from the OCS, we must pay royalties to the OCS on the revenue derived from the sale of products, technologies and services developed with the grants from the OCS. The terms of the OCS grants and the law pursuant to which grants are made restrict our ability to manufacture products or transfer technologies developed outside of Israel if OCS grants funded the development of the products or technology. This restriction may limit our ability to enter into agreements for those products or technologies without OCS approval. We cannot be certain that any approval of the OCS will be obtained on terms that are acceptable to us, or at all.

In order to meet specified conditions in connection with the grants and programs of the OCS, we have made representations to the Government of Israel about our Israeli operations. From time to time the conduct of our Israeli operations has deviated from our representations. If we fail to meet the conditions related to the grants, including the maintenance of a material presence in Israel, or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund the grants previously received (together with an adjustment based on the Israeli consumer price index and an interest factor) and would likely be ineligible to receive OCS grants in the future. The inability to receive these grants would result in an increase in our research and development expenses.

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

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

Israeli law may delay, prevent or make difficult a merger with or an acquisition of us, which could prevent a change of control and therefore depress the price of our shares.

Provisions of Israeli law may delay, prevent or make undesirable a merger or an acquisition of all or a significant portion of our shares or assets. 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 have the effect of delaying or preventing a change in control and may make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions may limit the price that investors may be willing to pay in the future for our ordinary shares. In addition, our articles of association contain certain provisions that may make it more difficult to acquire us, such as a staggered board and the ability of our board of directors to issue preferred stock. Furthermore, Israel tax considerations may make potential transactions undesirable to us or to some of our shareholders. See “Description of Share Capital – Possible Anti-Takeover Effects.”

The price of our ordinary shares may fluctuate significantly.

The market price for our ordinary shares, as well as the prices of shares of other technology companies, has been volatile. Between January 1, 2003 and May 20, 2005, our share price has fluctuated from a low of \$2.10 to a high of \$17.00. The following factors may cause significant fluctuations in the market price of our ordinary shares:

- fluctuations in our quarterly revenues and earnings or those of our competitors;
- shortfalls in our operating results compared to levels forecast by securities analysts;
- announcements concerning us, our competitors or telephone companies;
- announcements of technological innovations;
- the introduction of new products;
- changes in product price policies involving us or our competitors;
- market conditions in the industry;
- the conditions of the securities markets, particularly in the technology and Israeli sectors; and
- political, economic and other developments in the State of Israel and worldwide.

In addition, stock prices of many technology companies fluctuate significantly for reasons that may be unrelated or disproportionate to operating results. The factors discussed above may depress or cause volatility of our share price, regardless of our actual operating results.

The trading prices of our notes could be significantly affected by the market price of our ordinary shares.

We believe that the trading price of our notes is significantly affected by the market price of our ordinary shares, which may be affected by a variety of factors as set forth in the immediately preceding risk factor. This relationship may result in greater volatility in the trading prices of our notes than would be expected for non-convertible debt securities.

Our notes are effectively subordinated to our existing and future secured indebtedness and structurally subordinated to existing and future indebtedness and other liabilities of our subsidiaries.

Our notes are our general, unsecured obligations and are effectively subordinated to any existing and future secured indebtedness we may have. In addition, our notes are not guaranteed by our subsidiaries or any future subsidiaries and, accordingly, our notes are effectively subordinated to the existing and future indebtedness and other liabilities of our subsidiaries. These liabilities may include indebtedness, trade payables, guarantees, lease obligations and letter of credit obligations. Therefore, our rights and the rights of our creditors, including the holders of the notes, to participate in the assets of any subsidiary upon that subsidiary's liquidation or reorganization will be subject to the prior claims of the subsidiary's creditors, except to the extent that we may ourselves be a creditor with recognized claims against the subsidiary. However, even if we are a creditor of one of our subsidiaries, our claims would still be effectively subordinated to any security interests in, or mortgages or other liens on, the assets of that subsidiary and would be subordinate to any indebtedness of the subsidiary senior to that held by us. As of May 31, 2005, our existing subsidiaries had no outstanding indebtedness (excluding intercompany debt and other liabilities).

There are no restrictive covenants in the indenture for the notes relating to our ability to incur future indebtedness or complete other transactions.

The indenture governing our notes does not contain any financial covenants or restrictions on the payment of dividends. The indenture does not restrict the issuance or repurchase of securities by us or our subsidiaries. The indenture contains no covenants or other provisions to afford holders of our notes protection in the event of a highly leveraged transaction, such as a leveraged recapitalization, that would increase the level of our indebtedness, or a change in control except for the ability of the holders to require us to redeem the notes under certain circumstances. The indenture governing our notes does not restrict us from incurring senior secured debt in the future or from guaranteeing our indebtedness, nor does it limit the amount of indebtedness that we can issue that is equal to our notes in right of payment. If we or our subsidiaries were to incur additional debt or liabilities, our ability to pay our obligations on the notes could be adversely affected.

Our indebtedness and debt service obligations recently increased upon the issuance of our notes, which may adversely affect our cash flow, cash position and stock price.

We intend to fulfill our debt service obligations with respect to our notes from our existing cash, investments and operations. In the future, if we are unable to generate cash or raise additional cash financings sufficient to meet these obligations and need to use existing cash or liquidate investments in order to fund these obligations, we may have to delay or curtail research, development and commercialization programs.

Our indebtedness could have significant additional negative consequences, including, without limitation:

- requiring the dedication of a portion of our expected cash flow to service our indebtedness, thereby reducing the amount of our expected cash flow available for other purposes, including funding our research and development programs and other capital expenditures;

- increasing our vulnerability to general adverse economic conditions;
- limiting our ability to obtain additional financing; and
- placing us at a possible competitive disadvantage to less leveraged competitors and competitors that have better access to capital resources.

Holders of our notes are not be entitled to any rights with respect to our ordinary shares, but they are subject to all changes made with respect to our ordinary shares.

Holders of our notes are not entitled to any rights with respect to our ordinary shares (including, without limitation, voting rights and rights to receive dividends, if any, or other distributions on our ordinary shares), but such holders are subject to all changes affecting our ordinary shares. Holders of our notes are entitled to rights on the ordinary shares if and when we deliver ordinary shares to such holders in exchange for their notes. For example, in the event that an amendment is proposed to our articles of association requiring shareholder approval and the record date for determining the shareholders of record entitled to vote on the amendment occurs prior to delivery to a converting holder of our notes of our ordinary shares, such holders will not be entitled to vote on the amendment, although that holder will nevertheless be subject to any changes in the powers, preferences or special rights of our ordinary shares.

Our ability to fulfill our obligations under our notes is dependent upon our future financial and operating performance.

Our ability to make interest and principal payments on our notes when due and to satisfy our other debt obligations depends in part upon our future financial performance and upon our ability to renew or refinance any debt obligations or to raise additional equity capital. Prevailing economic conditions and financial, business and other factors, many of which are beyond our control, will affect our ability to make these payments.

If we are unable to generate sufficient cash flow to meet our debt services obligations, we will have to pursue one or more alternatives, such as:

- reducing our operating expenses;
- reducing or delaying capital expenditures;
- selling assets; or
- raising additional equity capital.

We cannot be sure that any of these alternatives could be accomplished on satisfactory terms, if at all, or that those actions would provide sufficient funds to retire the notes and our other debt obligations.

We may not have the ability to purchase our notes for cash if required to do so by holders on November 9, 2009, November 9, 2014 or November 9, 2019, or upon the occurrence of a fundamental change.

On November 9, 2009, November 9, 2014 or November 9, 2029, or upon specified fundamental changes relating to us, each holder of the notes may require us to purchase for cash all or a portion of such holder's notes at a price equal to 100% of the principal amount, plus accrued and unpaid interest, if any, on such notes to but excluding the date of purchase. In addition, in the case of certain fundamental changes occurring before November 9, 2009, we may be required to pay a make-whole premium to holders of the notes. We cannot be sure that we will have sufficient financial resources to purchase the notes for cash, or will be able to raise debt financing if we are required to purchase the notes at the option of the holders of such notes or upon the occurrence of a fundamental change. This repurchase requirement may also delay or make it harder for others to obtain control of us.

We do not anticipate declaring any cash dividends on our ordinary shares.

We have never declared or paid cash dividends on our ordinary shares and do not plan to pay any cash dividends in the near future. Our current policy is to retain all funds and earnings for use in the operation and expansion of our business.

U.S. shareholders may be subject to adverse U.S. federal income tax consequences as a result of our possible status as a passive foreign investment company.

Based on the composition of our gross income and the composition and value of our gross assets during 2004, we do not believe that we would be treated as a passive foreign investment company ("PFIC") for U.S. federal income tax purposes for the 2004 tax year, although it is possible that we would have been classified as a PFIC in 2001, 2002 and 2003, and there can be no assurance that we will not be treated as a PFIC for 2004 or any subsequent tax year. If we are a PFIC for any tax year, U.S. shareholders who owned our ordinary shares during such year may be subject to increased United States federal income tax liabilities and reporting requirements for such year and succeeding years, even if we are no longer a PFIC in such succeeding years. We urge U.S. holders of our notes or ordinary shares to review Item 10E, – "Taxation – United States Tax Considerations – United States Federal Income Taxes – Passive Foreign Investment Company Status" in this Annual Report and to consult their own tax advisors with respect to the U.S. federal income tax consequences of an investment in our ordinary shares.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

AudioCodes Ltd. was incorporated in 1992 under the laws of the State of Israel. Our principal executive offices are located at 1 Hayarden Street, Airport City, Lod, 70151 Israel. Our telephone number is 972-3-976-4000.

Acquisition of Ai-Logix

On May 12, 2004, we acquired all of the outstanding shares of capital stock of Ai-Logix, Inc., a leading provider of advanced voice recording hardware technology. Ai-Logix had revenues of approximately \$13 million in 2003. Its offices are located in Somerset, New Jersey.

We paid \$10 million in cash at the closing and paid an additional \$10 million in March 2005 based on the achievement of revenue milestones by the Ai-Logix business during 2004 and 2005.

This acquisition was accounted for under the purchase method of accounting and, accordingly, the purchase price has been allocated to the assets and liabilities acquired based on their related fair values. We allocated \$1.4 million of the purchase price to current assets and liabilities (excluding cash and cash equivalents), \$329,000 to property and equipment, \$3.1 million to technology and \$3.8 million to goodwill. The results of Ai-Logix's operations have been included in our consolidated financial statements since the acquisition date.

Ai-Logix is a strategic provider of voice and data hardware integration cards for the call recording and voice/data logging industry. Ai-Logix provides a wide variety of voice processing cards to its customers, which include contact centers, public safety agencies, financial institutions, air traffic control and other government agencies. Its products include proprietary public exchange integration products as well the SmartWORKS™ family of products that are designed for all segments of the call recording industry. Ai-Logix offers voice processing cards that support all three product segments in the call recording industry, including passive analog trunk interface cards, passive digital trunk interface cards and passive digital PBX telephone set integration cards.

Recent trends evidence a growing momentum in the use of VoP technology in new network deployments and an expected shift of communications budgets in the enterprise market towards IP-based architectures. The call recording industry is experiencing similar trends. According to Datamonitor, the contact center market and the call logging and recording industries are rapidly adopting IP-based networking solutions. A significant portion of future voice recording and call logging revenues are expected to be generated from deployments of VoIP architectures. We believe that our acquisition of Ai-Logix will enhance our board line business and provide an entry into the call recording market and computer telephony integration (CTI) market by leveraging our VoP expertise with Ai-Logix's technology, strategic partnerships and customer base.

Sale of Our 2.00% Senior Convertible Notes Due 2024

In November 2004, we raised net proceeds of approximately \$120.2 million in a private placement of \$125.0 million aggregate principal amount of our 2.00% Senior Convertible Notes due 2024. These notes were issued pursuant to Rule 144A under the Securities Act of 1933. Holders of the notes are entitled to convert the notes into our ordinary shares at a conversion rate of 53.4474 ordinary shares per \$1,000 principal amount of notes, which is the equivalent to a conversion price of approximately \$18.71 per share. The conversion rate is subject to adjustment in certain circumstances, such as changes in our capital structure or upon the issuance by us of share dividends or certain cash distributions. The notes may be redeemed by us, in whole or in part at any time on or after November 9, 2009. The holders may require us to redeem the notes on November 9, 2009, November 9, 2014 or November 9, 2019, or upon certain fundamental changes.

Pursuant to a registration rights agreement among us and the initial purchasers of the notes, we agreed to file with the U.S. Securities and Exchange Commission within 150 days of November 9, 2004, a shelf registration statement covering the notes and ordinary shares issuable upon conversion of the notes and to maintain the effectiveness of the registration statement until the earlier of the date on which all the shares have been resold under the registration statement, the date of expiration of the holding period under applicable law that would enable the resale of the shares without restriction or registration under applicable law, or November 16, 2006. We filed this registration statement on April 5, 2005 and expect that it will become effective shortly after we file this Annual Report on Form 20-F.

Acquisition of UAS

In April 2003, we purchased from Nortel Networks Limited selected assets of its Universal Audio Server business, or UAS. As part of the transaction, Nortel Networks granted to us a license to use its UAS technology. We have undertaken to act as an exclusive supplier to Nortel Networks for its UAS products over a period of three years. In addition, the parties have entered into a development agreement in relation to future platforms.

The UAS products provides enhanced conferencing, multi-language announcement functionality, and other regulatory media server applications for voice over packet networks. We are seeking to leverage the UAS product and technology in order to further enhance our media server products and increase related sales.

The consideration for the transaction amounted to \$5.5 million, of which \$2.0 million was paid at the closing, \$2.0 million was paid nine months after the closing and \$1.5 million was paid in April 2004. Under the terms of the acquisition agreement, we also paid \$1.0 million upon Nortel Networks completing product integration under the development agreement. The acquisition was accounted for under the purchase method of accounting and, accordingly, the purchase price has been allocated to the assets acquired based on their related fair values. We allocated \$380,000 of the purchase price to property and equipment, \$1.2 million to technology and \$5.3 million to goodwill. The results of the UAS operations have been included in our consolidated financial statements since the acquisition date.

We also made additional payments of \$4.9 million in 2004 to Nortel Networks under the acquisition agreement based on net orders for UAS products placed by Nortel. These payments were not considered part of the acquisition cost and were offset against related revenues earned by us from orders by Nortel Networks during 2004.

Introduction

We design, develop and market enabling technologies and system products for the transmission of voice, data and fax communications over packet networks, which we refer to as the new voice infrastructure. Our products enable our customers to build high-quality packet networking equipment and provide the building blocks to connect traditional telephone networks to the new voice infrastructure. Our products are sold to leading original equipment manufacturers, or OEMs, system integrators and network equipment providers in the telecommunications and networking industries.

Packet networks are data communications networks that transport information compressed into “packets” over circuits shared simultaneously by several users. Equipment based on advanced voice communications standards enables packet networks to carry voice and data more efficiently than the traditional telephone networks, which were designed principally to transmit high quality voice calls.

Our voice compression technology permits the high quality transmission of voice over packet networks using substantially less network capacity than used in traditional telephone networks. Our products enable our customers to build highly-efficient, high capacity gateways and access equipment that are used to connect traditional telephone networks to packet networks. In addition, our gateway product offering provides our customers with a substantial building block for voice over packet carrier-based solutions, as an alternative to our customers developing or building their own gateways.

Our products consist of:

- Signal processor chips, which process voice, data and fax signals and compress this information into packets so that it can be sent between traditional telephone networks and packet networks.
- Communications boards and modules for communication system products that are deployed on both access networks and enterprise networks. The carrier network applications for these boards and modules include media gateways, which terminate calls from the Public Switched Telephone Network (PSTN), packetize and compress the call and then switch the call to the packet network, and vice-versa. The enterprise applications for these products include Computer Telephony Integration (CTI) deployments for contact centers, providing call logging and recording utilizing either industry standard or proprietary protocols.
- System products, including media servers and media gateways, for access networks, trunking applications in carrier networks, and enterprise networks. These systems enable voice, data and fax to be transmitted over Internet and other protocols, and interface with third party equipment to facilitate the introduction of enhanced voice and data services. Media servers provide enhanced conferencing, multi-language announcement functionality, and other media server applications for voice over packet networks. Our media gateway products include low density analog media gateways and low, mid and high density digital media gateways.

Our products are based upon voice compression and fax detection technologies, which transform voice and fax transmissions into small digital “packets.” We were involved in the development of the voice coding standard that was adopted for use in packet networks by the Voice over IP Forum, an industry group founded to ensure the interoperability and high quality of telephone service over packet networks. We have also developed advanced technologies for processing compressed voice transmissions and have significant voice communication system design expertise.

We sell our products to leading original equipment manufacturers, system integrators and distributors in the telecommunications and networking industries for use in markets providing:

- telephony over packet networks based on Internet protocols or networks based on asynchronous transfer mode standards, known as ATM standards;
- telephony over the wireless or cable television infrastructure; and
- telephone service over high speed modems operating over wireless links or data modems, known as digital subscriber line, or DSL, modems.

Customers for our products consist of OEMs, network equipment providers and systems integrators. In addition, our proprietary voice compression technology is licensed to a broad group of companies that manufacture equipment for a variety of markets. As one of the original developers of the standards for voice compression technology used in packet networks, we are positioned to take advantage of the rapidly growing demand for advanced communications components enabling high quality converged voice and data services.

Industry Background

Market Trends

The networking and telecommunications industries have experienced rapid change over the last few years. The primary factors driving this change include the following:

- *Growth in data communications traffic.* The growth of the Internet has led to a surge in data communications traffic. This growth has been fueled by the increasing number of users of the Internet, as well as by the increased use of electronic mail and multimedia content and the increased volume of information retrieved from the World Wide Web. In addition, organizations are increasingly turning to the use of intranets and private networks to increase productivity and create competitive advantages. This proliferation of intranets and private networks has further contributed to the surge in data traffic.
- *Emergence of packet networks and advances in networking technologies.* Traditional voice communications networks were not designed to handle the dramatic increase in data traffic, the need for high-speed data communication and the need to serve a much larger number of users. As data traffic becomes the dominant factor in communications and as service providers begin to build and maintain converged networks for integrated voice and data services, a new generation of data-centric networks is being developed. This development has been enabled by a new generation of packet networking technologies. The capabilities to effectively carry voice and fax and preserve the quality of communications over these new networks have been made possible by the recent rapid advances in voice compression technologies, the advent of digital signal processing chips and new packet voice, fax and data networking technologies and protocols. The surge in data traffic has led to the need for new packet-based infrastructures. As a result, service providers are seeking to exploit the advances in high speed and packet voice networking technologies to build networks that are more cost effective than the traditional circuit-switched telephone networks.

- *Competition in the telecommunications industry.* Competitive local exchange carriers and alternative carriers are trying to penetrate the local telephone market with varying degrees of success by bypassing the incumbent local telephone company network through the use of emerging packet technologies in new functions like telephony transmission over cable networks and digital subscriber line networks. In addition, there is a growth of toll bypass service providers, who seek to use public or private networks in order to bypass incumbent networks. Although these new and traditional service providers are not our direct customers, they are creating market demand for equipment manufactured by our customers. The surge in data traffic and the growth in overall volume and capacity of infrastructures has also created a need for new infrastructure equipment that is capable of more efficient utilization of the available networks.

- *New technologies.* The expected extension of voice over packet technologies into wireless networks alongside the introduction of new wireless standards (referred to often as Second and Third Generations) and cable networks suggest a business opportunity for the deployment of such technologies and products in these market segments. It is possible that the introduction of Voice over Packet technologies into wireless and cable networks will then place pressure on the traditional circuit switch service providers to modernize their equipment so as to be able to compete with the new offerings, including price reductions of these alternative networks.

Circuit-Switched versus Packet Networks

Traditionally, voice, data and fax communications have been transmitted and managed on separate networks, each with its own distinct industry standards and protocols. Voice, data and fax have been transmitted primarily over the traditional telephone network that is based on circuit-switched technology. When a call is placed on a circuit-switched network, a dedicated circuit is established between the two callers and is maintained for the duration of the call. This dedicated channel, which requires bandwidth of 64 kilobits per second, is unavailable for use by other callers on the network until the call is terminated.

Packet networks differ fundamentally from circuit-switched networks in that the packet network's resources and infrastructure can be shared simultaneously by several users and bandwidth can be flexibly allocated. Packet-based communications systems format the information to be transmitted, such as e-mail, voice, fax and data, into a series of smaller digital packages of information called "packets." Each of these packets is then transmitted over the network and is reassembled as a complete communication at the receiving end. The various packet networks employ different network protocols for different applications, priority schemes and addressing formats to ensure reliable communication.

Packet networks offer a number of advantages over circuit-switched networks. Rather than requiring a dedicated circuit for each individual call, packet networks commingle packets of voice, fax and data from several communications sources on a single physical link. This provides superior utilization of network resources, especially in dealing with information sources with bursts of information followed by periods of silence. This superior utilization means that the same amount of traffic can be carried using fewer network resources. Additionally, the integration of voice and data communications makes possible an enrichment of services and an entire range of new, value-added applications, such as unified messaging and voice enabled web sites. In addition, voice traffic over packet networks is usually compressed to provide a further reduction in the use of or demand for bandwidth. For example, the rate at which information is transmitted over packet networks is generally between 6.3 and 8 kilobits per second as compared to 64 kilobits per second over circuit-switched telephone networks.

Convergence of Voice and Data

The proliferation of data-centric networks since the mid-1990s has made the transmission of voice and fax over these networks a cost-effective alternative to existing circuit-switched telephone networks. Most of the recent growth in packet networks has taken place over networks based on Internet protocols, and, to a lesser extent, on packet networks based on other protocols. "Voice over IP", or VoIP, is the industry terminology used to describe the transmission of voice over Internet protocol-based networks.

The need to re-route voice and fax traffic from the traditional circuit-switched networks onto the new packet networks has led to the development of interface equipment between the two networks, generally referred to as gateways or access equipment, depending on the type of network. The processing of the voice and fax signals in gateway and access equipment is done according to industry-wide standards. These standards are needed to ensure that all traditional telephony traffic is seamlessly switched and routed over the packet network and vice versa.

Gateway equipment for Internet protocol-based packet networks has continued to experience significant development and growth. The gateway equipment can be generally divided into two key categories: open telecommunications architecture systems, built around industry-standard PC and workstation platforms for which components are available from a number of suppliers, and proprietary architecture-based gateways which are built around a custom design of a telecommunications equipment manufacturer. Voice over IP gateway equipment can be generally segmented into three classes: carrier class gateways for use in central office facilities; enterprise gateways for use by corporations and in small offices; and residential gateways for use at homes.

Despite the inherent advantages and the economic attractiveness of packet voice networking, the transmission of packet voice and fax poses a variety of technological challenges. These challenges relate to quality of service, reliability of equipment, functionality and features, and ability to provide a good return on investment.

Quality of Service. The most critical issues leading to poor quality of service in the transmission of voice and fax over packet networks are packet loss, packet delay and packet delay jitter. For real time signals like voice, the slightest delay in the arrival of a packet may render that packet unusable and, in a voice transmission, the delayed packet is considered a lost packet. Delay is usually caused by traffic hitting congestion or a bottleneck in the network. The ability to address delay is compounded by the varying arrival times of packets, called packet-jitter, which results from the different routes taken by different packets. This "jitter" can be eliminated by holding the faster arriving packets until the slower arriving packets can catch up, but this introduces further delay. These idiosyncrasies of packet networks do not noticeably detract from the quality of data transmission since data delivery is relatively insensitive to time delay. However, even the slightest delay or packet loss in voice and fax transmission can have severe ramifications such as voice quality degradation or, in the case of a fax transmission, call interruption. Therefore, the need to compensate for lost or delayed packets without degradation of voice and fax quality is a critical issue.

Gateway Reliability. In order for a packet network to be efficient for voice or fax transmission, the gateway equipment must be able to deliver an equivalent level of performance to that of existing switching equipment located at central offices. The telephony providers' central offices contain circuit-switching equipment that typically handles tens of thousands of lines and is built to meet severe performance criteria relating to reliability, capacity, size, power consumption and cost. To date, the gateways available for use in packet networks have not been able to cost-effectively achieve these same levels of reliability in handling similar numbers of voice and fax calls. As a result, new generation gateway equipment that meets the same performance level as current circuit-switch technologies needs to be developed.

Functionality. In order to compete effectively with incumbent circuit-switching equipment, packet network equipment must be able to deliver equivalent and improved functionality and features for the service providers and network users.

Return on Investment. With the reduction in profitability of service providers there is an even greater need for them to achieve better returns on investment from capital expenditures on new equipment. Given the evolving nature of packet technologies and capabilities, there is greater pressure to provide cost effective technological solutions.

In order to maximize the benefits of using packet networks for the transmission of voice data and fax, products must be able to address and solve these inherent problems and challenges. These products must also be standards-based to support interoperability among different equipment manufacturers and to allow operation over various networks.

AudioCodes Solution

Using our proprietary voice compression algorithms and industry standards, advanced digital signal processing techniques and voice communications system design expertise, our products address the quality of service problems posed by packet delay, packet delay jitter and packet loss. As a result, we enable our customers to build packet networking equipment that provides communication quality comparable to the traditional telephone networks. In addition, our communications boards and modules improve gateway efficiency and provide the building blocks for high performance, large capacity, open telecommunications platform-based gateways. We work closely with our customers, tailor our products to meet their specific needs, assist them in integrating our products within their systems and help them bring their systems to market on a timely basis. We also work with our customers in deploying their systems in various network environments.

We believe that the following strengths have enabled us to develop our products and provide services to our customers:

- *Leadership in voice compression technology.* We are a leader in voice compression technology. Voice compression exploits redundancies within a voice signal to reduce the bit rate of data required to digitally represent the voice signal while still maintaining acceptable voice quality. Our key development personnel have significant experience in developing voice compression technology. We were involved in the development of the ITU G.723.1 voice coding standard that was adopted by the Voice over IP Forum and the International Telecommunications Union as the recommended standard for use in voice over IP gateways. We implement industry voice compression standards and work directly with our customers to design state-of-the-art proprietary voice compression algorithms that satisfy specific network requirements. We believe that our significant knowledge of the basic technology permits us to optimize its key elements and positions us to address further technological advances in the industry. We also believe that our technological expertise has resulted in us being sought out by leading equipment manufacturers to work with them in designing their systems and provision of solutions to their customers.
- *Digital signal processing design expertise.* Our extensive experience and expertise in designing advanced digital signal processing algorithms enables us to implement them efficiently in real time systems. Digital signal algorithms are computerized methods used to extract information out of signals. In designing our signal processors, we use minimal digital signal processing memory and processing power resources. This allows us to develop higher density solutions than our competitors. Our expertise is comprehensive and extends to all of the functions required to perform voice compression, fax and modem transmission over packet networks and telephone signaling processing.
- *Compressed voice communications systems design expertise.* We have the expertise to design and develop the various building blocks and the complete gateways and media servers required for complete voice over packet systems. In building these systems, we develop hardware architectures, voice packetization software and signaling software, and integrate them with our signal processors to develop a complete, high performance compressed voice communications system. We assist our customers in integrating our signal processors into their hardware and software systems to ensure high voice quality, high completion rate of fax and data transmissions and telephone signaling processing accuracy. Further, we are able to customize our off-the-shelf products to meet our customers' specific needs, thereby providing them with a complete, integrated solution and enabling them to market their products with a reduced time to market.

We believe that our products possess the following advantages:

- *Voice over Packet signal processors.* Our multi-channel signal processors enable our customers and us to create products that meet the reliability, capacity, size, power consumption and cost requirements needed for building high capacity gateways.
- *Multiple and comprehensive product lines.* We address both the standards-based open telecommunications architecture market or the proprietary system market, we are able to address both segments. We can do this because we enable our customers to offer multiple applications and address different market segments. For example, our voice over IP communications boards target the open telecommunications architecture market, while our signal processors, modules and voice packetization software target the proprietary system market. Our analog and digital media gateways target access, trunking and enterprise applications and our digital media gateways target wireless, wireline and cable networks.
- *Extensive feature set.* Our products incorporate an extensive set of signal processing functions and features (such as protocols, coders), functionalities (such as H.323, Media Gateway Control Protocol (MGCP), Media Gateway Control (Megaco) and Session Initiated Protocol (SIP)) and implement a complete system. We offer the ability to manage multiple channels of communications working independently of each other, with each channel capable of performing all of the functions required for voice compression, fax and modem transmission, telephone signaling processing and other functions. These functions include voice, fax or data detection, echo cancellation, telephone tone signal detection and generation and other telephony signaling processing.
- *Open architecture.* Our voice over packet communications boards target the open architecture gateway market segment, which enables our customers to use hardware and software products widely available for standards-based open telecommunications platforms. We believe that this provides our customers with an improved time to market and the benefits of scalability, upgradeability and enhanced functionality without the need to completely redesign their systems for evolving applications.

- *Various entry level products.* Our wide product range (chips to media gateways and media servers) provides our customers with a range of entry level products. We believe that these building blocks enable our customers to significantly shorten their time to market by adding their value added solution.
- *VoIPerfect™ architecture.* Our VoIPerfect architecture serves as the underlying technology platform common to all of our products since 1998. VoIPerfect™ is regularly updated and upgraded with features and functionalities required to comply with evolving standards and protocols. VoIPerfect™ architecture comprises VoP digital signal processing, or DSP, software and media streaming embedded software, integrated public telephone switched network, or PTSN, signaling protocols and VoIP standard control protocols, provisioning and management engines. Additional features enable carrier-grade quality and high availability. VoIPerfect™ architecture components are available in AudioCodes' products at various levels of integration – from the chip level, through peripheral component interconnect Mezzanine Card, or PMC, modules and PCI/compact PCI (cPCI) blades, to high-availability and non-high-availability analog and digital media gateway platforms.

Business Strategy

Our goal is to be the leading provider of enabling technologies and products for the transmission of voice, data and fax over packet networks. The following are key elements of our strategy:

- *Maintain and extend technological leadership.* We intend to capitalize on our expertise in voice compression technology and proficiency in designing voice communications systems. In 1995, we co-authored the ITU G.723.1 voice coding standard that was adopted by the Voice over IP Forum as the recommended standard for use in voice over IP gateways. In 1998, we introduced NetCoder®, a new voice coder that was designed specifically for IP networks. In 2001, we introduced TrunkPack®1610, a cPCI Telephony board supporting PSTN, signaling, MGCP and MEGACO call controls. In 2002, we introduced the Mediant™2000 Media Gateway as part of our initiative to provide complete media gateways to our network equipment provider. In 2002, we also launched our media server product family to support IP-based local access and enhanced services for wireless, cable, voice virtual private network and IP centrex markets. We have invested heavily and are committed to continued investment in developing technologies that are key to providing high performance voice, data and fax transmission over packet networks and to be at the forefront of technological evolution in our industry.
- *Strengthen and expand strategic relationships with key customers.* Our strategy has been to sell our products to leading equipment manufacturers in the telecommunications and networking industries and to establish and maintain long-term working relationships with them. We work closely with our customers to engineer products and subsystems that meet each customer's particular needs. The long development cycles usually required to build equipment incorporating our products frequently results in close working relationships with our customers. By focusing on leading equipment manufacturers with large volume potential, we believe that we reach a substantial segment of our potential customer base while minimizing the cost and complexity of our marketing efforts.

- *Expand and enhance the development of highly-integrated products.* We plan to continue designing, developing and introducing new product lines and product features that address the increasingly sophisticated needs of our customers. We believe that our knowledge of core technologies and system design expertise enables us to offer better solutions that are more complete and contain more features than competitive alternatives. We believe that the greatest opportunities for our growth and profitability will come from the development of even more highly-integrated product lines and product features such as our recently announced digital media gateways.
- *Build upon existing technologies to penetrate new markets.* The technology we developed in connection with the IP telephony market can be used to serve similar product requirements in emerging markets utilizing similar packet networking technologies. These markets include those providing telephony over digital subscriber lines, wireless networks and the cable television infrastructure.
- *Develop a network of strategic partners.* Part of our strategy has been to sell our products through customers that can offer our products as part of a full-service solution to their customers. We expect to further develop our strategic partner relationships with system integrators and other service providers in order to increase our customer base.
- *Acquire complementary businesses and technologies.* We expect to pursue the acquisition of complementary businesses and technologies or the establishment of joint ventures to broaden our product offerings, enhance the features and functionality of our systems, increase our penetration in targeted markets and expand our marketing and distribution capabilities. As part of this strategy, we acquired the UAS business from Nortel in April 2003 and Ai-Logix in May 2004.

Products

Our products facilitate the transmission of voice, data and fax over packet networks. To date, we have incorporated our algorithms, technologies and systems design expertise in nine product lines:

- voice over packet processors;
- media gateway modules;
- VoIP and VoATM communication boards;
- enhanced voice services and contact center solutions;

- analog media gateways for toll bypass access and enterprise applications;
- digital media gateways with various capacities for wireless (Stretto™), wireline (Mediant™) and cable (Mediant™ Cable);
- IPmedia™ boards and servers for enhanced services and functionalities such as conferencing and messaging (IPmedia™ Platforms);
- universal audio server (IP Media™ Media Server);
- Element management system (EMS); and
- Voice and data logging hardware integration board products.

In addition, we continue to offer customers our professional services, which usually involve customization and development projects for customers.

Our products are designed to build on our core technology and competence extending them both vertically (chips inserted into boards, boards inserted into digital media gateways) and horizontally into different applications for different market segments, such as enterprise, wireline, cable and wireless.

Voice Over Packet Processors

Our signal processor chips compress and decompress voice, data and fax communications. This enables these communications to be sent from circuit-switched telephone networks to packet networks. Our chips are digital signal processors on which we have embedded our algorithms. These signal processor chips are the basic building blocks used by our customers and us to enable their products to transmit voice, fax and data over packet networks. These chips may be incorporated into our communications boards, Media Gateway Modules and Analog Media Gateways for access and enterprise applications or they may be purchased separately and incorporated into other boards or customer products.

Our signal processor chips implement a complete signal processing system, supporting voice compression, echo cancellation, fax and modem processing and telephony signaling processing. The signal processor chips also enhance gateway efficiency by supporting multiple independently processed channels of communication.

We provide a range of voice over packet processors of voice communications over different types of packet networks, such as IP and ATM. Our processors are used by original equipment manufacturers, known as OEMs, in their products enabling simple development and a significant reduction in time-to-market. Each processor constitutes a full voice band subsystem that includes standards-based low bit rate voice compression, echo cancellation, in-band signaling detection and generation fax transmission and other signaling tones handling.

Media Gateway Modules

Our media gateway modules are medium to high density, multi-protocol modules that allow OEM gateway designers to take full advantage of the complete media gateway functionality inherent in our TrunkPack[®] architecture, which is installed in millions of lines worldwide. These modules connect as daughter cards onto proprietary OEM carrier boards and convert content into low bit rate packetized voice over IP voice trunking. Their comprehensive feature set and standard interfaces make them an integral building block for high performance, carrier class media gateways by providing fast time to market and a cost effective solution.

In common with our TrunkPack[®] boards and compact peripheral component interconnect, or PCI, solutions for open standards-based platforms. These modules bridge the gap between our voice over packet processors, which offer developers maximum design flexibility, and the communication boards that fit into standard peripheral component interconnect, or PCI, or CompactPCI platforms.

The module product family performs a variety of media gateway functions such as packetization, compression, streaming and protocol processing. The module line also provides echo cancellation functionality.

VoIP and VoATM Communication Boards

Our communications boards are designed to operate in gateways connecting the circuit-switched telephone network to packet networks based on Internet protocols. Our boards comply with voice over IP and voice over ATM (AAL2) industry standards and allow for interoperability with other gateways. The boards also enable high capacity operations while fitting into a single PCI or CompactPCI platforms. Just as our signal processor chips can handle multiple channels on a single processor, our communications boards can support multiple telephony trunk processing and differing modes of operations to provide manufacturers with greater system flexibility.

Our boards support standards-based open telecommunications architecture systems and combine our signal processor chips with communications software, signaling software and proprietary hardware architecture to provide a cost efficient interoperable solution for high capacity gateways. We believe that using open architecture permits our customers to bring their systems to market quickly and to integrate our products more easily within their systems.

Our boards represent a combined functionality of both media streaming processing (voice fax and modem) and on-board telephony interfaces, along with their associated signaling protocols.

Enhanced Voice Services and Contact Center Solutions

Our Ardito[™] media gateway boards offer developers of enhanced voice services and contact center solutions the capability to support PSTN infrastructure today and VoIP foundations in the future.

MediaPack™, our analog media gateways for toll bypass access and enterprise applications, empower the next-generation network by providing cost-effective, cutting-edge technology solutions that deliver voice and fax services to the corporate market, small businesses and home offices. Our analog media gateways for access and enterprise applications provide media streaming functionality while being either controlled by a centralized call agent or use on-box VoIP control protocols (H.323, MGCP and SIP). Convergence of data, voice and fax is achieved by a combination of the media gateway with any IP access technology, eliminating the cost of multiple access circuits. This product family utilizes our experience and digital signal processing, or DSP, technology for echo cancellation, voice compression, silence suppression and comfort noise generation.

The MediaPack™ family represents a feature rich product for streaming voice quality with a powerful analog interface supporting all major control protocols such as H323, SIP, MGCP and MEGACO.

Digital Media Gateways with Various Capacities for Wireless (Stretto™) Wireline (Mediant™) and Cable (Mediant™ Cable.)

Mediant™ is our family of media gateways for wireline backbone and enterprise networks. The Mediant™ product family offers scalability and functionality, providing a full suite of voice coders standard compliant control protocols and public switched telephone network, or PSTN, signaling interfaces for a variety of wireline media gateway applications in most softswitch control environments. The Mediant™ family provides carriers with a comprehensive line of different sized gateways. Small or medium-sized gateways enable cost-effective solutions for enterprise or small points of presence, as well as entry into fast growing new and emerging markets. The large gateway scales to central office capacities and is designed to meet carriers' operational requirements. The entire Mediant™ gateway family shares our same VoIP media gateway boards, assuring mature, field-proven solutions.

The Mediant™ cable access gateway family is our line of packet telephony standards-compliant cable access gateways designed for either hybrid or all IP cable network architecture. The Mediant cable access gateway enables deployment of advanced packet-based cable telephony at multiple service operators own pace, without costly hardware changes. The Mediant™ cable access gateway can be initially deployed as a V5.2 IP access terminal and then easily migrated by software upgrade to a cable telephony media gateway with external call management provided by a softswitch and an SS7 interface to the PSTN. Our Stretto™ product line is our family of media gateways for the second and third generations of wireless networks. Stretto™ is intended to enable packetization of legacy wireless networks, as well as serving as a voice media gateway in third generation packet enabled architecture. The Stretto™ product family is compatible with popular wireless voice coders and protocols for wireless networks such as code-division multiple access (CDMA), global system for mobile communications (GSM), CDMA2000 and universal mobile telecommunications service (UMTS), and builds on our TrunkPack® architecture, which is installed in millions of lines worldwide.

0IPmedia™ Boards and Servers for Enhanced Services and Functionalities such as Conferencing and Messaging (IPmedia™ Platforms)

The IPmedia™ product family is designed to allow OEMs to provide sophisticated content and services that create revenue streams and customer loyalty through the ability to provide additional services. The IPmedia™ platforms interface both packet (IP or ATM) and switched-circuit telephony modules, while saving space. The IPmedia™ platform provides voice and fax processing capabilities to enable, together with our partners, an architecture for development and deployment of enhanced services.

IPmedia™ platforms are designed to answer the growing market demand for enhanced voice services over packet networks, particularly network-based applications like unified communications, call recording, and conferencing by carriers and application service providers. IPmedia™ enables our customers to develop and market applications such as: unified communications, interactive voice response, call-centers, conferencing and voice-activated personal assistant. IPmedia™ products are currently offered on our PCI and cCPI boards and on the 2000 series 1U media gateway box (IPmedia™ 2000) and will soon also be available in the recently announced 3000 series 2U gateway platform, featuring IP and ATM interfaces and capabilities.

Universal Audio Server (IPmedia™ Media Server)

The universal audio server is a product that we acquired from Nortel Networks in April 2003. This product has been redesigned, upgraded and integrated into our IPmedia boards and servers. The universal audio server provides enhanced conferencing, multi-language announcement functionality, lawful intercept capabilities and other media server applications for voice over packet networks.

Element Management System (EMS)

Our Element Management System (EMS), is an advanced solution for centralized, standard-based management of our VoP gateways, covering all areas vital to the efficient operations, administration, management and provisioning of our Mediant™, Stretto™ and MediaPack™ VoP gateways.

Our EMS offers network equipment providers and system integrators fast setup of medium and large VoP networks with the advantage of a single centralized management system that configures, provisions and monitors all of AudioCodes gateways deployed, either as Customer Premises Equipment, access or core network platforms.

Voice and Data Logging Hardware Integration Board Products

The SmartWORKS™ family of products is our voice and data logging hardware integration board product line. SmartWORKS™ boards for the call recording and voice voice/data logging industry are compatible with a multitude of Private Branch Exchange, or PBX, telephone system integrations.

Core Technologies

We believe that one of our key competitive advantages is our broad base of core technologies ranging from advanced voice compression algorithms to complex architecture system design. We have developed and continue to build on a number of key technology areas.

Low Bit Rate Voice Compression Algorithms

Voice compression techniques are essential for the transmission of voice over packet networks. Voice compression exploits redundancies within a voice signal to reduce the bit rate required to digitally represent the voice signal, from 64 kilobits per second, or kbps, down to low bit rates ranging from 5.3 kbps to 8 kbps, while still maintaining acceptable voice quality. A bit is a unit of data. Different voice compression algorithms, or coders, make certain tradeoffs between voice quality, bit rate, delay and complexity to satisfy various network requirements. Use of voice activity detection techniques and silence removal techniques further reduce the transmission rate by detecting the silence periods embedded in the voice flow and discarding the information packets which do not contribute to voice intelligibility.

We are one of the innovators in developing low bit rate voice compression technologies. Our patented MP-MLQ™ coder was adopted in 1995 by the ITU as the basis for the G.723.1 voice coding standard for audio/visual applications over the circuit-switched telephone networks. By adhering to this standard, system manufacturers guarantee the interoperability of their equipment with the equipment of other vendors.

Advanced Digital Signal Processing Algorithms

To provide a complete voice over packet communications solution, we have developed a library of digital signal processing functions designed to complement voice compression coders with additional functionality, including: echo cancellation; voice activity detection; facsimile and data modem processing; and telephony signaling processing. Our extensive experience and expertise in designing advanced digital signal processing solutions allows us to implement algorithms using minimal processing memory and power resources. Our algorithms include:

- *Echo cancellation.* Low bit rate voice compression techniques introduce considerable delay, necessitating the use of echo cancellation algorithms. The key performance criterion of an echo canceller is its ability to deal with large echo reflections, long echo delays, fast changing echo characteristics, diverse telecommunications equipment and network effects. Our technology achieves low residual echo and fast response time to render echo effects virtually unnoticeable.
- *Fax transmission.* There are two widely used techniques for real time transmission of fax over networks based on Internet protocols: fax relay and fax spoofing. Fax relay takes place when a fax is sent from a fax machine through a gateway over networks based on Internet protocols in real time to a fax machine at the other end of the network. At the gateway, the analog fax signals are demodulated back into digital data, converted into packets, routed over the packet network and reassembled at the receiving end. Fax relay is used when the round trip network delay is small (typically below one second). When the round trip network delay increases, one of the fax machines may time out while waiting for a response from the other fax machine to arrive.

- *Data modem technology.* We have developed data modem technologies that facilitate data relay over packet networks. Our data modem relay software algorithms support all existing data modem standards up to a bit rate of 14.4 kbps.
- *Telephony signaling processing.* Various telephony signaling standards and protocols are employed to route calls over the traditional telephone network, some of which use “in-band” methods, which means that the signaling tones are sent over the telephone line just like the voice signal. As a result, in-band signaling tones may have to undergo the compression process just like the voice signal. Most low bit-rate voice coders, however, are optimized for speech signals and exhibit poor tone transfer performance. To overcome this, our processors are equipped with tone detection and tone generation algorithms. To provide seamless transparency between the traditional telephone network and packet networks for signaling, we employ various digital signal processing techniques for efficient tone processing.

Voice Communications Software

To transmit the compressed voice and fax over packet networks, voice packetization processes are required to construct and deconstruct each packet of data for transmission. The processing involves breaking up information into packets and adding address and control fields information according to the specifications of the appropriate packet network protocol. In addition, our software provides the interface with the signal processors and addresses packet delay and packet loss issues.

Media Processing

Our media processing products provide the enabling technology and platforms for developing enhanced service applications for legacy and next generation networks. We have developed media processing technologies such as message recording/playback, announcements, voice coding and mixing and call progress tone detection that enable our customers to develop and offer advanced revenue generating services such as conferencing, network announcements, voice mail and interactive voice response. Our media processing technology and products offer PSTN and packet interfaces to enable flexible deployment options.

Digital Cellular Communications Technology

Convergence of wireline and wireless networks is becoming a key driver for deployment of voice over packet networks, enabling operators to use common equipment for both networks, thus lowering capital expenditures and operating expenses, while offering enriched services.

Our cellular voice over packet products provide a cost effective solution for these convergence needs, complying with 2G and 3G cellular standards, for GSM/UMTS and CDMA/CDMA2000 networks. These include support for cellular vocoders (concurrently with wireline vocoders), interfaces and protocols. These interfaces and protocols are being defined by special standardization groups (e.g., 3GPP and 3GPP2) and include capabilities such as handling IP, ATM and TDM concurrently, mediation (mobile to mobile calls with no transcoding), support for handoff and lawful intercept and various other cellular-specific capabilities.

VoIP for Telephony over Cable Networks

Telephony over cable networks is characterized by technical challenges due to the intrinsic nature of the cable system which broadcasts across the subscriber network. The cable telephony market is divided into two main standards: softswitch solutions and IP access terminal, or IPAT, V5.2 solutions utilizing Class 5 switches. We have developed media gateway technology that is capable of supporting both standards while migration from IPAT solutions to softswitch solutions may be done by a software only upgrade, thus protecting the end customer's investment. Our technology complies with PacketCable standards including security/encryption technology, support for quality of service, call control and signaling.

Hardware Architectures for High Density Multi-Trunk Voice over Packet Systems

Our voice over packet product offerings include high density, multi-trunk voice over packet systems for standards-based open telecommunications platforms in access equipment. Multi-trunk processing is centered around a design encompassing two key processing elements, signal processors performing voice, fax and data processing and a communications processor. Overall system performance, reliability, capacity, size, cost and power consumption are optimized, based on our hardware architecture, which supports high throughput rates for multi-trunk processing. On-board efficient network and system interfaces relieve the system controller from extensive real time data transfer and processing of data streams.

Carrier Grade System Expertise

To provide state of the art carrier grade media gateways, we have developed a wide expertise in a number of fields essential to such a product line. We have developed or integrated the various components required to implement a full digital media gateway solution that behaves as a unified entity to the external world. This required a major investment in adapting standard cPCI platforms to our needs. Such adaptation included optimizing power supply and cooling requirements, adding centralized shelf controllers, fabric switches and alarm cards to the chassis. Another aspect of the expertise developed to undertake this task is related to High Availability software and hardware design. High Availability is a required feature in any carrier grade media gateway platform. We have also developed a sophisticated EMS (Element Management System) to complete our offering. This EMS enables the user to provision and monitor a number of media gateways from a centralized location.

Customers

Our customers consist of OEMs, network equipment providers and systems integrators and distributors. Historically, we have derived the majority of our revenues from sales to a small number of customers. The identities of our principal customers have changed, and we expect that they will continue to change, from year to year. We expect that a small number of customers will continue to account for a large percentage of our sales. Our largest customer in terms of our sales for the year ended December 31, 2004 was Nortel Networks.

Sales to Nortel Networks accounted for 14.3% of our revenues in 2003 and 18.6% of our revenues in 2004. No other customer accounted for more than 8.0% of our revenues in 2003 or in 2004.

Sales and Marketing

Our sales and marketing strategy is to achieve design wins with industry leaders in our targeted markets. Prospective customers generally must make a significant commitment of resources to test and evaluate our products and to integrate them into larger systems. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. For these reasons, the sales cycles of our products to new customers are often lengthy, averaging approximately six to twelve months after achieving a design win. This time may be further extended because of internal testing, field trials and requests for the addition or customization of features.

We also provide our customers with reference platform designs, which enable them to achieve easier and faster transitions from the initial prototype designs we use in the test trials through final production releases. We believe this significantly enhances our customers' confidence that our products will meet their market requirements and product introduction schedules.

We market our products in the United States, Europe, Asia, Latin America and Israel primarily through a direct sales force. Marketing managers are dedicated to principal customers to promote close cooperation and communication. Additionally, we market our products in these areas through independent sales representatives and system integrators. We select these independent entities based on their ability to provide effective field sales, marketing communications and technical support to our customers. We have generally entered into a combination of exclusive and non-exclusive sales representation agreements with these representatives in each of the major countries in which we do business. These agreements are typically for renewable 12-month terms, are terminable at will by us upon 90 days notice, and do not commit the sales representative to any minimum sales of our products to third parties. Some of our representatives have the ability to return some of the products they have previously purchased and purchase more up to date models.

Manufacturing

Texas Instruments Incorporated supplies all of the signal processor chips used for our signal processors. The communications processor currently used on our communications boards is manufactured by Motorola. We believe that similar communications processors are available from other suppliers. Other components are generic in nature and we believe they can be obtained from multiple suppliers.

We have not entered into any long-term supply agreements. To date, we have been able to obtain sufficient amounts of these components to meet our needs and do not foresee any supply difficulty in obtaining timely delivery of any parts or components. However, an interruption in supply from any of these sources, especially with regard to signal processors from Texas Instruments Incorporated, or an unexpected termination of the manufacture of certain electronic components could disrupt production, thereby adversely affecting our results. We generally maintain an inventory of critical components used in the manufacture and assembly of our products although our inventory of signal processor chips would likely not be sufficient in the event that we had to engage an alternate supplier for these components.

We utilize contract manufacturing for substantially all of our manufacturing processes. Until the third quarter of 2002, all of our boards, modules and analog media gateways were assembled by third-party subcontractors in Israel. Since the third quarter of 2002, we have extended our manufacturing capabilities through third party subcontractors in the United States and in China. Our subsidiary, Ai-Logix, utilizes third-party subcontractors in the United States and Mexico to manufacture its products. Our internal manufacturing activities consist primarily of the production of prototypes, test engineering, materials purchasing and inspection, final product configuration and quality control and assurance.

Competition

Competition in our industry is intense and we expect competition to increase in the future. There has been a significant amount of merger and acquisition activity and strategic alliances, frequently involving major telecommunications equipment manufacturers acquiring smaller companies, and we expect that this will result in an increasing concentration of market share among these companies, many of whom are our customers.

Our principal competitors in the sale of signal processing chips for voice over packet are Texas Instruments, Broadcom, Infineon, Centillium, Mindspeed, Netergy and VoicePump, a subsidiary of DSP Group. We expect that large manufacturers of generic signal processors, such as Motorola, Agere Systems and Intel will market competing processors. Competition for our module level products include semiconductor manufacturers such as Texas Instruments, Mindspeed, Centillium Performance Technologies Inc. and Spectrum Signal Processing Inc. Our principal competitors in the communications board market are NMS Communications, Intel, Motorola, Brooktrout, Inc., Acculab and PIKA Technologies, Inc.

Our principal competitors in the area of media gateways are Cisco Systems Inc., Mediatrix Telecom, Inc., VegaStream Limited, Samsung, Innovaphone AG, Quintum Technologies, Tainet Communication System Corp., Welltech, Ascii Corp, D-Link Systems, Inc., Multitec Inc., Innomedia, OKI, LG. Cisco Systems, Veraz Networks, Sonus Networks, Nuera, Tekelec, General Bandwidth, Telica and Commatch. In addition we face competition in mid and high density gateways from internal development at companies such as Nortel, Lucent, Alcatel, Siemens, Huawei, UTstarcom, ZTE and others.

Some of our competitors have greater name recognition, larger installed customer bases and significantly greater financial, technical and marketing resources than we do. As a result of the ongoing consolidation in our industry, several of our competitors have greater financial, personnel and other resources, offer a broader range of products and services than we do.

Intellectual Property and Proprietary Rights

Our success is dependent in part upon proprietary technology. We rely primarily on a combination of patent, copyright and trade secret laws, as well as confidentiality procedures and contractual provisions, to protect our proprietary rights. We also rely on trademark protection concerning various names and marks that serve to identify it and our products. While our ability to compete may be affected by our ability to protect our intellectual property, we believe that, because of the rapid pace of technological change in our industry, maintaining our technological leadership and our comprehensive familiarity with all aspects of the technology contained in our signal processors and communication boards is also of primary importance.

We own U.S. patents that relate to our voice compression technology. We also actively pursue patent protection in selected other countries of interest to us. In addition to patent protection, we seek to protect our proprietary rights through copyright protection and through restrictions on access to our trade secrets and other proprietary information which we impose through confidentiality agreements with our customers, suppliers, employees and consultants.

There are a number of companies besides us who hold or may acquire patents for various aspects of the technology incorporated in the ITU's standards or other industry standards or proprietary standards, for example, in the fields of wireless and cable. While we have obtained cross-licenses from some of the holders of these other patents, we have not obtained a license from all of the holders. The holders of these other patents from whom we have not obtained licenses may take the position that we are required to obtain a license from them. Companies that have submitted their technology to the ITU (and generally other industry standards making bodies) for adoption as an industry standard are required by the ITU to undertake to agree to provide licenses to that technology on reasonable terms. Accordingly, we believe that even if we were required to negotiate a license for the use of such technology, we would be able to do so at an acceptable price. Similarly, however, third parties who also participate with respect to the same standards-setting organizations as do we may be able to negotiate a license for use of our proprietary technology at a price acceptable to them, but which may be lower than the price we would otherwise prefer to demand.

Under a pooling agreement dated March 3, 1995, as amended, between AudioCodes and DSP Group, Inc., on the one hand, and France Telecom, Universite de Sherbrooke and their agent, Sipro Lab Telecom, on the other hand, we and DSP Group, Inc. granted to France Telecom and Universite de Sherbrooke the right to use certain of our specified patents, and any other of our and DSP Group, Inc. intellectual property rights incorporated in the ITU G.723.1 standard. Likewise France Telecom and Universite de Sherbrooke granted AudioCodes and DSP Group, Inc. the right to use certain of their patents and any other intellectual property rights incorporated in the G.723.1 standard. In each case, the rights granted are to design, make and use products developed or manufactured for joint contribution to the G.723.1 standard without any payment by any party to the other parties.

In addition, each of the parties to the agreement granted to the other parties the right to license to third parties the patents of any party included in the intellectual property required to meet the G.723.1 standard, in accordance with each licensing party's standard patent licensing agreement. The agreement provides for the fee structure for licensing to third parties. The agreement provides that certain technical information be shared among the parties, and each of the groups agreed not to assert any patent rights against the other with respect of the authorized use of voice compression products based upon the technical information transferred. Licensing by any of the parties of the parties' intellectual property incorporated in the G.723.1 standard to third parties is subject to royalties that are specified under the agreement.

Each of the parties to the agreement is free to develop and sell products embodying the intellectual property incorporated into the G.723.1 standard without payment of royalties to other parties, so long as the G.723.1 standard is implemented as is, without modification. The agreement expires upon the last expiration date of any of the AudioCodes, DSP Group, Inc., France Telecom or Universite de Sherbrooke patents incorporated in the G.723.1 standard. The parties to the agreement are not the only claimants to technology underlying the G.723.1 standard.

We are aware of parties who may be infringing our technology that is part of the G.723.1 standard. We evaluate these matters on a case by case basis, directly or through our licensing partner. Although we have not yet determined whether to pursue legal action, we may do so in the future. There can be no assurance that any legal action will be successful.

Third parties have claimed, and from time to time in the future may claim, that our past, current or future products infringe their intellectual property rights. Intellectual property litigation is complex and there can be no assurance of a favorable outcome of any litigation. Any future intellectual property litigation, regardless of outcome, could result in substantial expense to us and significant diversion of the efforts of our technical and management personnel. Litigation could also disrupt or otherwise severely impact our relationships with current and potential customers as well as our manufacturing, distribution and sales operations in countries where relevant third party rights are held and where we may be subject to jurisdiction. An adverse determination in any proceeding could subject us to significant liabilities to third parties, require disputed rights to be licensed from such parties, assuming licenses to such rights could be obtained, or require us to cease using such technology and expend significant resources to develop non-infringing technology. We may not be able to obtain a license at an acceptable price.

We have entered into technology licensing fee agreements with third parties. We expect that in the ordinary course of business we may be required to enter into additional licensing agreements. Under one agreement, we agreed to pay a third party royalty fees until 2008, based on 0.75% of our revenues.

Legal Proceedings

We are not a party to any material legal proceedings.

C. ORGANIZATIONAL STRUCTURE

List of Significant Subsidiaries

AudioCodes Inc., our wholly-owned subsidiary, is a Delaware corporation.

AudioCodes National Inc., a wholly-owned subsidiary of AudioCodes Inc., is a Delaware corporation.

Ai-Logix Inc., a wholly owned subsidiary of AudioCodes Inc., is a Delaware corporation

AudioCodes Europe Limited, our wholly-owned subsidiary, is incorporated in England.

In 2005, we incorporated in Brazil AudioCodes Brasil Equipamentos de Voz sobre IP Ltda, a wholly-owned subsidiary.

D. PROPERTY, PLANTS AND EQUIPMENT

We lease our main facilities, located in Airport City, Lod, Israel, which currently occupy approximately 111,000 square feet. We moved into these facilities in February 2004 which enabled us to consolidate all of our operations in Israel into one location.

Our U.S. subsidiary leases a 7,356 square foot facility in San Jose, California. Our subsidiary has additional offices in Raleigh, Chicago, Boston and Dallas. We also have a leased representative office in Beijing, China and in Tokyo, Japan.

Our U.S. subsidiary, Ai-Logix, Inc., leases a 29,000 square foot facility in Somerset, New Jersey.

We believe that these properties are adequate to meet our current needs. We may need to increase the size of our current facilities, seek new facilities, close certain facilities or sublease portions of our existing facilities in order to address our needs in the future.

Rent expense was \$1,713,000 in 2002, \$1,829,000 in 2003, and \$2,927,000 in 2004. We project that our rent expense for 2005 will be approximately \$2,705,000.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, or US GAAP. These accounting principles require management to make certain estimates, judgments and assumptions based upon information available at the time that they are made, historical experience and various other factors that are believed to be reasonable under the circumstances. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented.

On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition and allowance for sales returns, allowance for doubtful accounts, inventories, investment in an affiliated company and goodwill. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

In many cases, the accounting treatment of a particular transaction is specifically dictated by US GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. Our management has reviewed these critical accounting policies and related disclosures with our Audit Committee. See Note 2 to the Consolidated Financial Statements, which contain additional information regarding our accounting policies and other disclosures required by US GAAP.

Management believes the significant accounting policies that affect its more significant judgments and estimates used in the preparation of its consolidated financial statements and are the most critical to aid in fully understanding and evaluating AudioCodes' reported financial results include the following:

- Revenue recognition and allowance for sales returns;
- Allowance for doubtful accounts;
- Inventories;
- Investment in an affiliated company; and
- Goodwill

Revenue Recognition and Allowance for Sales Returns

We generate our revenues primarily from the sale of products. We sell our products through a direct sales force and sales representatives. Our products are generally a bundled hardware and software solution that is delivered together to our customers, which include original equipment manufacturers (OEMs), network equipment providers, systems integrators and distributors of a variety of telecommunications and networking products, all of whom are considered end users.

Revenues from products are recognized when the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery of the product has occurred, (iii) the fee is fixed or determinable and (iv) collectability is probable. We have no obligation to customers after the date on which products are delivered, other than pursuant to warranty obligations and any applicable right of return. We generally grant our customers the right of return or the ability to exchange a specific percentage of the total price paid for products they have purchased over a period of three months for other products.

We maintain a provision for product returns and exchanges. This provision is based on historical sales returns, analysis of credit memo data and other known factors. This provision is deducted from revenues, and amounted to \$272,000 in 2002, \$294,000 in 2003 and \$619,000 in 2004.

Revenues from the sale of products which were not yet determined to be final sales due to market acceptance or technological compatibility were deferred and included in deferred revenues.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts. Management exercises its judgment as to our ability to collect outstanding receivables. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically reviewed, provisions are made based upon the age of the receivable. In determining the provision, we analyze our historical collection experience and current economic trends. If the historical data used to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the "moving average cost" method for raw materials and on the basis of direct manufacturing costs for finished products. We periodically evaluate the quantities on hand relative to current and historical selling prices and historical and projected sales volume and technological obsolescence. Based on these evaluations, inventory write-offs and write-down provisions are provided to cover risks arising from slow moving items, technological obsolescence, excess inventories, discontinued products and for market prices lower than cost. We wrote-off and wrote-down inventory in a total amount of \$1.7 million in 2002, \$835,000 in 2003 and \$1.2 million in 2004.

Investment in an Affiliated Company

Through December 31, 2004, we had invested an aggregate of \$2.5 million in a privately-held company engaged in speech recognition. We currently own approximately 40% of the equity in this company. This investment is accounted for by the equity method and is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable. As of December 31, 2004, based on management's most recent analyses, no impairment losses have been identified in connection with this investment.

SFAS No.142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment at the reporting unit level by comparing the fair value of the reporting unit with its carrying value. In connection with our acquisition of selected assets of UAS, we recognized \$4.3 million of goodwill in 2003 and an additional \$1.0 million of goodwill in 2004. We recognized \$3.8 million of goodwill in 2004 in connection with our acquisition of Ai-Logix. We paid an additional \$10 million in March 2005 based on the achievement of revenue milestones by the Ai-Logix business during 2004 and 2005. This contingent was recorded as part of the acquisition cost as additional goodwill during 2005. Goodwill in connection with the UAS and Ai-Logix acquisitions was reviewed for impairment during the fourth quarter of 2004. No impairment losses have been identified in connection with these acquisitions.

A. OPERATING RESULTS

You should read this discussion with the consolidated financial statements and other financial information included in this Annual Report.

Overview

We design, develop and market enabling technologies and products for the transmission of high quality voice, data and fax over packet networks. Newly developed equipment based on advanced voice communications standards enables packet networks to carry voice and data more efficiently and at a lower cost than traditional telephone networks by using substantially less network capacity. Our products are designed to enable our customers to build packet voice networking equipment that provides comparable communication quality to that of traditional telephone networks. Our communication boards are the building blocks for connecting traditional telephone networks with packet voice networks and provide high performance and large capacity on open telecommunications platform-based gateways. We have continued to broaden our offerings as we have expanded in the last few years from selling chips to boards, subsystems, media gateway systems and media servers.

Our headquarters are in Airport City, Lod, Israel and we have eight additional offices worldwide: in the United States in San Jose, Boston, Chicago, Dallas, Raleigh and Somerset, New Jersey, as well as in Tokyo, Japan and Beijing, China.

In 2002, no customer accounted for more than 8.9% of our total revenues and our top five customers accounted for 30.2% of our total revenues. Nortel Networks accounted for 14.3% of our total revenues in 2003 and 18.6% of our total revenues in 2004 and our top five customers accounted for 34.2% of our total revenues in 2003 and 35.7% of our total revenues in 2004. Based on our experience, we expect that our largest customers may change from period to period. If we lose a large customer and fail to add new customers to replace lost revenue our operating results may be materially adversely affected.

Revenues based on the location of our customers for the last three fiscal years are as follows:

	2002	2003	2004
Americas	40.0%	56.9%	62.3%
Far East	37.4	23.7	14.3
Europe	10.7	12.6	13.3
Israel	11.9	6.8	10.1
Total	100.0%	100.0%	100.0%

Part of our strategy involves the acquisition of complementary businesses and technologies. Our first strategic acquisition involved the purchase of the UAS product group from Nortel Networks in April 2003. This acquisition added new media server technology and products that we could offer to our customers and provided us with research and development capability in the United States. As a result of our supply agreement with Nortel entered into in connection with this transaction, we significantly increased our sales to Nortel, with sales to Nortel accounting for 18.6% of our revenues in 2004 compared to 14.3% of our revenues in 2003 and 1.4% of our revenues in 2002. We expect that sales to Nortel will continue to account for a high percentage of our revenues in 2005.

We completed a second acquisition in May 2004, acquiring Ai-Logix, a leading provider of advanced voice recording hardware technology. We believe that this acquisition has enhanced our board line business and provides an entry into the call recording market and the computer telephony integration, or CTI, market by leveraging our VoP expertise with the technology, strategic partnerships and customer base of Ai-Logix. We paid \$10.0 million in cash at the closing of the transaction. We paid an additional \$10 million in March 2005 based on the achievement of revenue milestones by the Ai-Logix business during 2004 and 2005. The payment was recorded as part of the acquisition cost as additional goodwill in accordance with the provisions of SFAS No. 141 in 2005.

The increase in the percentage of our revenues from customers located in the Americas over the past two years was primarily the result of our increased sales in the United States. The increase in sales in the United States was primarily due to increased sales to Nortel as a result of our acquisition of the UAS product group and our acquisition of Ai-Logix.

We believe that prospective customers generally are required to make a significant commitment of resources to test and evaluate our products and to integrate them into their larger systems. As a result, our sales process is often subject to delays associated with lengthy approval processes that typically accompany the design and testing of new communications equipment. For these reasons, the sales cycles of our products to new customers are often lengthy, averaging approximately six to twelve months. As a result, we may incur significant selling and product development expenses prior to generating revenues from sales.

The currency of the primary economic environment in which our operations are conducted is the U.S. dollar, and as such, we use the dollar as our functional currency. Transactions and balances originally denominated in dollars are presented at their original amounts. All transaction gains and losses from the remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as financial income or expenses, as appropriate.

The accelerated demand for Voice over IP, or VoIP, technology has impacted our business during the last two years.. Over the past two years, the shift from traditional circuit-switched networks to next generation packet-switched networks continued to gain momentum. As data traffic becomes the dominant factor in communications, service providers are building and maintaining converged networks for integrated voice and data services. In addition, underdeveloped markets without basic wireline service in countries such as China and India are beginning to use VoP technology to deliver voice and data services that were previously unavailable. These trends are helping to overcome the downturn in the telecommunications industry that affected us during previous years.

Unfavorable economic conditions affected the communications sector during the period from 2000 to 2003. This caused a decrease in our revenues from 2000 to 2001 and from 2001 to 2002. It also resulted in our net losses in 2001, 2002 and 2003. Sales of products, particularly for applications in converged networks, to OEMs for use by large service providers declined significantly during these periods. In response to our revenue decreases, we implemented expense control programs to reduce operating expenses, while at the same time we continued to invest in developing products that we believe our customers will need as the market for telecommunications equipment improves. Many companies that had reduced their capital expenditures during the recent economic downturn have begun to invest again in their communications networks. The acceptance of next generation packet-switched networks is contributing to these infrastructure investments as enterprises and service providers begin to increase their use of IP networks for data traffic, such as fax transmissions, and VoIP. These improving market conditions helped our revenues to increase in 2003 and in 2004, and we expect our revenues in 2005 to exceed our revenues in 2004.

Results of Operations

The following table sets forth the percentage relationships of certain items from our consolidated statements of operations, as a percentage of total revenues for the periods indicated:

	Year Ended December 31,		
	2002	2003	2004
Statement of Operations Data:			
Revenues	100.0%	100.0%	100.0%
Cost of revenues	47.8	45.3	41.5
Gross profit	52.2	54.7	58.5
Operating expenses:			
Research and development, net	47.9	35.0	24.2
Selling and marketing	52.6	32.9	24.0
General and administrative	12.3	9.2	5.9
Total operating expenses	112.8	77.1	54.1
Operating income (loss)	(60.6)	(22.4)	4.4
Equity in losses of an affiliated company	1.1	1.0	0.6
Financial income, net	9.6	4.3	2.6
Income (loss) before taxes on income	(52.1)	(19.1)	6.4
Taxes on income	-	-	0.3
Net income (loss)	(52.1)%	(19.1)%	6.1%

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Revenues. Revenues increased 87.1% to \$82.8 million in 2004 from \$44.2 million in 2003. The increase in revenues was primarily due to an increase in sales in the United States, derived mainly from the inclusion of a full year of sales by our UAS product group, which was acquired in April 2003, and from sales generated as a result of our acquisition of Ai-Logix in May 2004. Our increase in revenues in 2004 also reflected the increased interest and activity in the market for packet-based VoIP products.

Gross Profit. Cost of revenues includes the manufacturing cost of hardware, quality assurance, overhead related to manufacturing activity and technology licensing fees payable to third parties. Gross profit increased to \$48.4 million in 2004 from \$24.2 million in 2003. Gross profit as a percentage of revenues increased to 58.5% in 2004 from 54.7% in 2003. The increase in our gross profit percentage was primarily a result of higher sales volume that allowed us to leverage our operations as our manufacturing overhead was spread over a larger sales base. In addition, gross profit percentage increased because of higher sales of integrated systems which usually have higher margins than sub-systems and chips. In the first quarter of 2004, we completed product integration and started shipping UAS platforms based on our hardware which allowed us to achieve better margins on these products. The increase in gross profit percentage was also due to our ability to offset the continued decline in average selling prices of our products with a reduction in manufacturing costs. The reduction in manufacturing costs was primarily due to a reduction in our raw material costs.

Research and Development Expenses. Research and development expenses consist primarily of compensation and related costs of employees engaged in ongoing research and development activities, development-related raw materials and the cost of subcontractors. Research and development expenses increased 29.3% to \$20.0 million in 2004, from \$15.5 million in 2003 and decreased as a percentage of revenues to 24.2% in 2004 from 35.0% in 2003. The increase in net research and development expenses was primarily due to additions to our research and development personnel resulting from the acquisition of the UAS product group from Nortel Networks during the second quarter of 2003 and the acquisition of Ai-Logix during the second quarter of 2004. We expect that research and development expenses will continue to increase in absolute dollar terms as a result of our continued development of new products.

Selling and Marketing Expenses. Selling and marketing expenses consist primarily of compensation for selling and marketing personnel, as well as exhibition, travel and related expenses. Selling and marketing expenses increased 36.8% in 2004 to \$19.9 million from \$14.5 million in 2003. As a percentage of revenues, selling and marketing expenses decreased to 24.0% in 2004 from 32.9% in 2003. The increase in selling and marketing expenses was primarily due to an increase in selling and marketing personnel and associated expenses, as well as additional personnel as a result of the acquisition of Ai-Logix. We expect that selling and marketing expenses will continue to increase in absolute dollar terms as a result of an expected increase in our sales force and marketing activities.

General and Administrative Expenses. General and administrative expenses consist primarily of compensation for finance, human resources, general management, rent, network and information systems and bad debt reserve, as well as insurance and professional services expenses. General and administrative expenses increased 19.3% to \$4.9 million in 2004 from \$4.1 million in 2003. As a percentage of revenues, general and administrative expenses decreased to 5.9% in 2004 from 9.2% in 2003. The increase in general and administrative expenses in 2004 was primarily the result of consolidating the expenses of our Ai-Logix subsidiary, which was acquired in May 2004. During 2003, we recorded \$924,000 of expenses in connection with our moving into our new premises in Israel. We did not have similar expenses in 2004. We expect that general and administrative expenses will increase in absolute dollar terms to support our expected growth.

Equity in Losses of Affiliated Company. Equity in losses of an affiliated company were \$516,000 in 2004 compared to \$429,000 in 2003. We believe that the products being developed by the affiliated company may enable us to enter new markets and to offer new products.

Financial Income, Net. Financial income consists primarily of interest derived on cash and cash equivalents and long term bank deposits and structured notes, net of interest accrued in connection with our senior convertible notes and bank charges. Financial income, net, in 2004 was \$2.2 million compared with financial income of \$1.9 million in 2003. The increase in financial income during 2004 was primarily due to higher interest rates and interest income, net, on the \$120.2 million of net proceeds from our sale of senior convertible notes in November 2004.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Revenues. Revenues increased 62.7% to \$44.2 million in 2003 from \$27.2 million in 2002. This increase was primarily due to a growing momentum in the shift from traditional circuit-switched networks to next generation packet-switched networks, as well as an increase of \$6.3 million in sales to Nortel Networks, primarily as a result of our acquisition of the UAS product group from Nortel.

Gross Profit. Gross profit increased 70.6% to \$24.2 million in 2003 from \$14.2 million in 2002. Gross profit as a percentage of revenues increased to 54.7% in 2003 from 52.2% in 2002. The increase in gross profit percentage resulted primarily from a reduction in inventory write-offs and write-downs which are included in the cost of revenues. These write-offs and write-downs were \$835,000 in 2003 compared to \$1.7 million in 2002. Inventory write-offs were higher in 2002 because of the effects of the slowdown in the telecommunications market. In addition, gross profit percentage benefited from manufacturing overhead being spread over a larger sales base.

Research and Development Expenses. Research and development expenses increased 18.8% to \$15.5 million in 2003, from \$13.0 million in 2002 and decreased as a percentage of total revenues to 35.0% in 2003 from 47.9% in 2002. The increase in research and development expenses in 2003 was primarily due to additions to our research and development personnel resulting from the acquisition of the UAS product group from Nortel Networks.

Selling and Marketing Expenses. Selling and marketing expenses increased 1.7% in 2003 to \$14.5 million from \$14.3 million in 2002. As a percentage of total revenues, selling and marketing expenses decreased to 32.9% in 2003 from 52.6% in 2002. The increase in selling and marketing expenses was primarily due to an increase in selling and marketing personnel and associated expenses.

General and Administrative Expenses. General and administrative expenses increased 21.3% to \$4.1 million in 2003 from \$3.4 million in 2002. As a percentage of total revenues, general and administrative expenses decreased to 9.2% in 2003 from 12.3% in 2002. The increase in general and administrative expenses was primarily due to expenses related to our moving into our new premises in Israel.

Equity in losses of Affiliated Company. Equity in losses of an affiliated company were \$429,000 in 2003 compared to \$300,000 in 2002. We believe that the products being developed by the affiliated company may enable us to enter new markets and to offer new products. As a result, during 2003, we increased our ownership in this company to 40%. We also adopted the equity method of accounting in 2003. Prior year results have been adjusted to reflect this investment at equity.

Financial Income, Net. Financial income consists primarily of interest derived on cash and cash equivalents and long term bank deposits and structured notes, net of bank charges. Financial income in 2003 was \$1.9 million compared with financial income of \$2.6 million in 2002. The decrease in financial income was primarily due to lower interest rates on cash and cash equivalents, and long term bank deposits and, to a lesser extent, a reduction in cash reserves.

Impact of Inflation, Devaluation and Fluctuation of Currencies on Results of Operations, Liabilities and Assets

Since the majority of our revenues are paid in or linked to the dollar, we believe that inflation and fluctuations in the NIS/dollar exchange rate have no material effect on our revenues. However, a portion of the cost of our Israeli operations, mainly personnel and facility-related, is incurred in NIS. Inflation in Israel and dollar exchange rate fluctuations, however, have some influence on our expenses and, as a result, on our net income. Our NIS costs, as expressed in dollars, are influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the NIS in relation to the dollar.

To protect against the changes in value of forecasted foreign currency cash flows resulting from payments in NIS, we maintain a foreign currency cash flow hedging program. We hedge portions of our forecasted expenses denominated in foreign currencies with forward contracts. These measures may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

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

Year ended December 31,	Israeli inflation rate %	NIS Devaluation Rate %	Israeli inflation adjusted for devaluation %
2002	6.5	7.3	(0.8)
2003	(1.9)	(7.6)	5.7
2004	1.2	(1.6)	2.8

Effective Corporate Tax Rate

Israeli companies are generally subject to corporate tax on their taxable income at a rate of 35% (in the 2004 tax year), 34% (in the 2005 tax year), 32% (in the 2006 tax year) and 30% (in 2007 and thereafter). However, the rate applicable to us is currently effectively reduced as detailed below. Our production facilities have been granted approved enterprise status in accordance with the Law for Encouragement of Capital Investments, 1959 under four separate investment programs, and consequently the income derived from these facilities is exempt from corporate tax in Israel for two or four years commencing in the year in which the specific approved enterprise first generates taxable income, and to corporate tax at a reduced rate of 10% to 25% for the following six or eight years (depending on the percentage of foreign shareholdings). Income from sources other than the approved enterprise during the benefit period will be subject to tax at the regular tax rate prevailing at that time. Our effective tax rate will be a weighted combination of the various applicable tax rates. See note 12 of the consolidated financial statements.

B. LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations for the last three years from the remaining proceeds from prior public offerings of our Ordinary shares. In November 2004, we raised net proceeds of approximately \$120.2 million in a private placement of \$125.0 million aggregate principal amount of our 2.00% Senior Convertible Notes due 2024. As of December 31, 2004, we had \$166.8 million in cash and cash equivalents and \$50.2 million in long-term bank deposits and structured notes.

In connection with our acquisition of Ai-Logix, we paid an additional \$10 million in March 2005 based on the achievement of revenue milestones by the Ai-Logix business during 2004 and 2005. This payment was recorded as part of the acquisition cost as additional goodwill during 2005.

Our operating activities provided cash in the amount of \$3.5 million in 2004, primarily due to our net income, depreciation and amortization expenses and an increase in trade payables and other payables and accrued expenses, which were partially offset by an increase in trade receivables and inventories and other receivables and prepaid expenses. Our operating activities used cash in the amount of \$6.5 million in 2003, primarily due to our net loss and an increase in trade receivables, which were partially offset by depreciation and amortization expenses and an increase in trade payables and other payables and accrued expenses. Our operating activities used cash in the amount of \$11.7 million in 2002, primarily due to our net loss and a decrease in other payables and accrued expenses, which were partially offset by depreciation and amortization expenses and a decrease in inventories.

In 2004, our investing activities used cash in the amount of \$15.9 million, primarily due to the acquisition of Ai-Logix and UAS and the purchase of property and equipment. In 2003, our investing activities provided cash in the amount of \$6.1 million primarily due to proceeds from short-term bank deposits, which were partially offset by investment in long-term bank deposits and structured notes, payments of \$4.4 million in connection with the acquisition of UAS and the purchase of property and equipment. In 2002, our investing activities provided cash in the amount of \$13.3 million primarily due to proceeds from short-term bank deposits which was offset in part by the purchase of property and equipment. Our capital expenditures were \$4.3 million in 2004, \$2.0 million in 2003 and \$2.1 million in 2002. The majority of our capital investment has been for testing equipment, an enterprise resources planning system, computers, peripheral equipment, software, office furniture and leasehold improvements. We used working capital to finance these expenditures.

In 2004, financing activities provided \$130.4 million, due to the net proceeds of \$120.2 million from our private placement of \$125.0 million aggregate principal amount of our 2.00% Senior Convertible Notes due 2024 and \$10.2 million from the issuance of shares upon exercise of options and from purchases under our Employee Stock Purchase Plans. In 2003, financing activities provided \$1.4 million due to issuance of shares upon exercise of options and from shares purchased under our Employee Stock Purchase Plans, partially offset by \$215,000 used to repurchase our ordinary shares. In 2002, financing activities used \$3.9 million to repurchase our ordinary shares, partially offset by \$757,000 from issuance of shares upon exercise of options and from shares purchased under our Employee Stock Purchase Plans.

We anticipate that our operating expenses will be a material use of our cash resources for the foreseeable future. We believe that our current working capital is sufficient to meet our present cash requirements. Part of our strategy is to pursue acquisition opportunities. If we do not have available sufficient cash to finance our operations and the completion of one or more acquisitions, we may be required to obtain additional debt or equity financing. We cannot be certain that we will be able to obtain, if required, additional financing on acceptable terms or at all.

Repurchase of Shares

In January 2001, our board of directors authorized us to repurchase up to 2,000,000 of our ordinary shares, and in April 2002, our board authorized the repurchase of an additional 2,000,000 of our ordinary shares, all subject to the discretion of our management. In 2001, we purchased 1,774,800 of our ordinary shares for an aggregate purchase price of approximately \$6,401,000. In 2002, we purchased 2,079,139 of our ordinary shares for an aggregate purchase price of \$4,703,486. In 2003, we purchased 88,200 of our ordinary shares for an aggregate purchase price of \$215,321.

C. *RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.*

Research and Development

In order to accommodate the rapidly changing needs of our markets, we place considerable emphasis on research and development projects designed to improve our existing products and to develop new ones. We are developing more advanced communications boards and analog and digital media gateways for carrier and enterprise applications. Our platforms will feature increased trunk capacity, new functionalities, enhanced signaling software and compliance with new control protocols. As of December 31, 2004, 213 of our employees were engaged primarily in research and development on a full-time basis. We also employed 9 persons on a part-time basis.

Our research and development expenses were \$20.0 million in 2004 compared to \$15.5 million in 2003 and \$13.0 million in 2002. From time to time we have received royalty-bearing grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS. As a recipient of grants from the OCS, we are obligated to perform all manufacturing activities for projects subject to the grants in Israel unless we receive an exemption. Know-how from the research and development which is used to produce products may not be transferred to third parties without the approval of the OCS. This approval is not required for the export of any products resulting from such research or development. Through December 31, 2004, we had obtained grants from the OCS aggregating \$1.2 million for certain of our research and development projects. We are obligated to pay royalties to the OCS, amounting to 3%-4% of the sales of the products and other related revenues generated from such projects, up to 100% of the grants received, linked to the U.S. dollar and bearing interest at the rate of LIBOR at the time of grant. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales no payment is required.

On December 16, 2004, the Financial Accounting Standards Board issued SFAS No. 123(R) (revised 2004), "Share-Based Payment", which is a revision of SFAS No. 123. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123 permitted, but not required, share-based payments to employees to be recognized based on their fair values while SFAS No. 123(R) requires all share-based payments to employees to be recognized based on their fair values. SFAS No. 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. Based on an amendment in April 2005, the new standard is effective at the beginning of the first annual period commencing after June 15, 2005. Accordingly, it will become effective for us on January 1, 2006. The adoption of SFAS 123(R) may have a significant effect on the Company's results of operations.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". SFAS No. 151 amends Accounting Research Bulletin ("ARB") No. 43, "Restatement and Revision of Accounting Research Bulletins", Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect that the adoption of SFAS No. 151 will have a material effect on our financial position or results of operations.

TREND INFORMATION

The accelerated demand for VoIP technology has impacted our business during the last two years. Over the past two years, the shift from traditional circuit-switched networks to next generation packet-switched networks continued to gain momentum. As data traffic becomes the dominant factor in communications, service providers are building and maintaining converged networks for integrated voice and data services. In addition, underdeveloped markets without basic wireline service in countries such as China and India are beginning to use VoP technology to deliver voice and data services that were previously unavailable. These trends are helping to overcome the downturn in the telecommunications industry that affected us during the previous years.

In 2004, we continued to experience pressure to shorten our lead times in supplying products to customers. Some of our customers are implementing "demand pull" programs by which they only purchase our product very close to the time, if not simultaneously with the time, they plan to sell their product. We are increasing our sales efforts in new markets, such as Latin America, Eastern Europe and Far East. We have introduced system level products, and new applications in our product lines. . We are still experiencing low visibility into customer demand for our products and our ability to predict our level of sales.

Unfavorable economic conditions affected the communications sector during the period from 2000 to 2003. This caused a decrease in our revenues from 2000 to 2001 and from 2001 to 2002. It also resulted in our net losses in 2001, 2002 and 2003. Sales of products, particularly for applications in converged networks, to OEMs for use by large service providers declined significantly during these periods. In response to our revenue decreases, we implemented expense control programs to reduce operating expenses, while at the same time we continued to invest in developing products that we believe our customers will need as the market for telecommunications equipment improves. Many companies that had reduced their capital expenditures during the recent economic downturn have begun to invest again in their communications networks. The acceptance of next generation packet-switched networks is contributing to these infrastructure investments as enterprises and service providers begin to increase their use of IP networks for data traffic, such as fax transmissions, and VoIP. These improving market conditions helped our revenues to increase in 2003 and in 2004, and we expect our revenues in 2005 to exceed our revenues in 2004.

E. *OFF-BALANCE SHEET ARRANGEMENTS*

We do not have any “off-balance sheet arrangements” as this term is defined in Item 5E of Form 20-F.

F. *TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS*

As of December 31, 2004, our contractual obligations were as follows (in thousands):

	PAYMENTS DUE BY PERIOD				
	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER 5 YEARS
Rental and lease commitments	21,003	2,705	5,095	4,758	8,445
Total cash obligations	21,003	2,705	5,095	4,758	8,445

Our obligation for accrued severance pay under Israel’s Severance Pay Law as of December 31, 2004 was \$5.0 million, of which \$4.5 million was funded through deposits into severance pay funds, leaving a net obligation of approximately \$440,000.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. *DIRECTORS AND SENIOR MANAGEMENT*

The following table sets forth certain information with respect to our directors, senior executive officers and key employees at April 30, 2005:

Name	Age	Position
Shabtai Adlersberg	52	Chairman of the Board, President and Chief Executive Officer
Nachum Falek	34	Vice President, and Chief Financial Officer
Eyal Frishberg	46	Vice President, Operations
Eli Nir	38	Vice President, Research and Development
Lior Aldema	39	Vice President, Marketing and Product Management
Ben Rabinowitz	38	Vice President, Marketing and Sales, North America
Yehuda Hershkovitz	38	Vice President, Systems
Tal Dor	36	Vice President, Human Resources
Gary Drutin		Vice President, Channel Operations and Marketing
Moshe Tal	51	President and Chief Executive Officer, Ai-Logix Inc.
Joseph Tenne	49	Director
Dana Gross	38	Director
Dr. Eyal Kishon	45	Director
Doron Nevo	49	Director

Shabtai Adlersberg co-founded AudioCodes in 1993, and has served as our Chairman of the Board and Chief Executive Officer since inception. Mr. Adlersberg co-founded DSP Group, a semiconductor company, in 1987. From 1987 to 1990, Mr. Adlersberg served as the Vice President of Engineering of DSP Group, and from 1990 to 1992, he served as Vice President of Advanced Technology. As Vice President of Engineering, Mr. Adlersberg established a research and development team for digital cellular communication which was spun-off in 1992 as DSP Communications. Mr. Adlersberg also serves as Chairman of the Board of Directors of Natural Speech Communication Ltd. Mr. Adlersberg holds an M.Sc. in Electronics and Computer Engineering from Tel Aviv University and a B.Sc. in Electrical Engineering from the Technion-Israel Institute of Technology, or the Technion.

Nachum Falek joined AudioCodes in April 2000 and became our Vice President, and Chief Financial Officer in November 2003. From 2000 to 2003, he served as Director of Finance. Prior to joining AudioCodes, Mr. Falek served as Controller at ScanVec-Amiable Ltd. From 1998 to 1999, he was a Manager at Ernst & Young in Israel. Mr. Falek holds a B.A. in Accounting and Economics from Haifa University, an M.B.A. from Tel Aviv University, and is a licensed CPA in Israel.

Eyal Frishberg has served as our Vice President, Operations since October 2000. From 1997 to 2000, Mr. Frishberg served as Associate Vice President, SDH Operations in ECI Telecom Ltd., a major telecommunication company. From 1987 to 1997, Mr. Frishberg worked in various operational positions in ECI Telecom including as manager of ECI production facility and production control. Mr. Frishberg worked from 1994 until 1997 for ELTA company, part of Israeli Aircraft Industries in the planning and control department. Mr. Frishberg holds a B.Sc. in Industrial Engineering from Tel Aviv University and an M.B.A. from Ben-Gurion University of the Negev.

Eli Nir has served as our Vice President, Research and Development since April 2001. He has been employed by us since 1996, when he founded and headed our System Software Group in our research and development department. Prior to 1996, Mr. Nir served as an officer in the Technical Unit of the Intelligence Corps of the Israeli Defense Forces (Major), heading both operational units and large development groups mostly related to digital processing. Mr. Nir holds an M.B.A. and an M.Sc. from Tel Aviv University in Digital Speech Processing and a B.Sc. from the Technion.

Lior Aldema has served as our Vice President, Product Management since January 2002. Mr. Aldema has also served as our Vice President Marketing since February 2003. He has been employed by us since 1998, when he was team leader and later headed our System Software Group in our research and development department. Prior to 1998, Mr. Aldema served as an officer in the Technical Unit of the Intelligence Corps of the Israeli Defense Forces (Major), heading both operational units and large development groups related to various technologies and headed one of the largest projects conducted in the IDF and executed by the Israeli Defense industry corporations. Mr. Aldema holds an M.B.A. from Tel Aviv University and a B.Sc. from the Technion.

Ben Rabinowitz joined us in December, 1999 and became our Vice President of Marketing and Sales for North America in October 2004. Previously, Mr. Rabinowitz served as Vice President of our Systems Group. From 1998 to 1999, Mr. Rabinowitz served as Director for Product Marketing at Westell Inc., a broadband access company. From 1997 to 1998, Mr. Rabinowitz served as Senior Director within the strategy practice of Technology Solutions Company, a technology consulting firm. Mr. Rabinowitz also previously served in Ernst & Young's consulting practice from 1994 to 1997, and provided consulting services to telecommunications companies. Mr. Rabinowitz holds an M.B.A. from Georgetown University.

Yehuda Hershkovits has served as our Vice President, Systems Group since 2003. From 2001 to 2003, Mr. Hershkovits served as our Vice President, Advanced Products. From 2000 to 2001, Mr. Hershkovits served as our Director of Advanced Technologies. From 1994 to 1998 and during 1999, Mr. Hershkovits held a variety of research and development positions at Advanced Recognition Technologies, Ltd., a voice and handwriting recognition company, heading its research and development from 1999 to 2000 as Vice President, Research and Development. From 1998 to 1999, Mr. Hershkovits developed various wireless communication algorithms at Comsys, a telecommunications company. Mr. Hershkovits holds an M.Sc. and a B.Sc., from the Technion both in the area of telecommunications.

Tal Dor has served as our Vice President of Human Resources since March 2000. For more than three years prior to March 2000, Ms. Dor acted as a consultant in Israel to, among others, telephone and cable businesses, as well as health and social service organizations. Ms. Dor holds a B.A. in psychology, from Ben-Gurion University of the Negev and an M.A. in psychology from Tel Aviv University.

Moshe Tal joined us in May 2004 in connection with the acquisition of Ai-Logix, Inc. and serves as the President and CEO of our Ai-Logix subsidiary. Mr. Tal co-founded Ai-Logix, Inc. in 1991, and has served as its President and CEO since 1998. Mr. Tal has more than twenty-five years of product design and engineering experience, principally associated with analog and digital signal processing technologies. Mr. Tal holds a B.Sc. in Electronic Engineering from Tel Aviv University. He also served in the Israeli Navy as a Submarine Communication System Technician.

Gary Drutin joined us in 2004 as Vice President of Channel Operations and Marketing. From 2001 until 2004 Mr. Drutin was Country Manager and General Manager for Cisco Israel, Cyprus and Malta and from 1997 until 2001 served as regional sales manager for service providers and enterprises for Cisco Israel. From 1990 until 1997, he served in sales management roles at Digital Equipment Corporation Israel. Mr. Drutin holds an M.B.A degree from Tel-Aviv University in Information Systems and Marketing and a B.Sc. degree in Computer Engineering from the Technion.

Joseph Tenne has served as one of our directors since June 2003. Mr. Tenne is currently the Chief Financial Officer of Ormat Technologies, Inc., a company listed on the New York Stock Exchange, which is engaged in the geothermal and recovered energy business. From 2003 to 2004 Mr. Tenne was the Chief Financial Officer of Treofan Germany GmbH & Co. KG, a German company, which is engaged in the development, production and marketing of oriented polypropylene films, which are mainly used in the food packaging industry. From 1997 until 2003, Mr. Tenne was a partner in Kesselman & Kesselman, Certified Public Accountants in Israel and a member of PricewaterhouseCoopers International Limited. Mr. Tenne holds a B.A. in Accounting and Economics and an M.B.A. from Tel Aviv University. Mr. Tenne is also a Certified Public Accountant in Israel.

Dana Gross has served as one of our directors since June 2000. Ms. Gross has served as Chief Marketing Officer of M-Systems Flash Disk Ltd. since April 2000, and as a director of M-Systems since September 2000. Prior to that, Ms. Gross served as Executive Vice President of the DiskOnChip business unit of M-Systems from 2000 and as Vice President of Worldwide Sales of M-Systems from 1998 until April 2000. Ms. Gross joined M-Systems in July 1992 as Vice President of Operations and became Chief Financial Officer in 1994, President of M-Systems Inc. in 1995 and Executive Vice President of Business Development in 1997. Ms. Gross also serves as a director of PowerDsine Ltd., a Power over Ethernet technology company that is traded on Nasdaq. Ms. Gross holds a B.Sc. in Industrial Management Engineering from Tel Aviv University and an M.B.A. from San Jose State University.

Dr. Eyal Kishon has served as one of our directors since 1997. Since 1996, Dr. Kishon has been Managing Partner of Genesis Partners, an Israel based venture capital fund. From 1993 to 1996, Dr. Kishon served as Associate Director of Dovrat-Shrem/Yozma-Polaris Fund Limited Partnership. In his capacity as Managing Partner of Genesis, Dr. Kishon serves as a director of VCON Telecommunications Ltd., a video conferencing technology company. From 1991 to 1992, Dr. Kishon was a Research Fellow in the Multimedia Department of IBM Science & Technology. From 1989 to 1991, Dr. Kishon worked in the Robotics Research Department of AT&T Bell Laboratories. Dr. Kishon holds a B.A. in Computer Science from the Technion and an M.Sc. and a Ph.D. in Computer Science from New York University.

Doron Nevo has served as one of our directors since 2000. From 1996 to 1999, Mr. Nevo served as President and CEO of NKO, Inc. Mr. Nevo established NKO in early 1995 as a startup subsidiary of Clalcom, Ltd. NKO designed and developed a full scale carrier grade IP Telephony system platform and established its own IP network. From 1992 to 1996, Mr. Nevo was President and CEO of Clalcom Ltd. Mr. Nevo established Clalcom in 1992 as a fax service provider in Israel. Mr. Nevo is President and CEO of KiloLambda Technologies Ltd. an optical subsystems company. He also serves on the board of a number of companies such as: Utility Wireless Corp. (a manufacturer of radio frequency sub-systems), Elcom Technologies (manufacturer of Satcom and Digital Radio synthesizers), Notox, Ltd. (a biotech company) and Cellaris, Ltd. (a new materials company). Mr. Nevo holds a B.Sc. in Electrical Engineering from the Technion and an M.Sc. in Telecommunications Management from Brooklyn Polytechnic.

B. COMPENSATION

The aggregate direct remuneration paid to all 14 persons who served in the capacity of director or senior executive officer during the year ended December 31, 2004 was approximately \$1.3 million, including \$168,000 which was set aside for pension and retirement benefits. This does not include amounts expended by us for automobiles made available to our officers, expenses (including business, travel, professional and business association dues and expenses) reimbursed to officers and other fringe benefits commonly reimbursed or paid by companies in Israel.

Stock options to purchase our ordinary shares granted to persons who served in the capacity of director or executive officer under our 1997 and 1999 Stock Option Plans are generally exercisable at the fair market value at the date of grant, and expire ten years (under the 1997 Plan) and seven years (under the 1999 Plan), respectively, from the date of grant. The options are generally exercisable in four or five equal annual payments, commencing one year from the date of grant.

A summary of our stock option activity and related information for the years ended December 31, 2002, 2003 and 2004 for all 14 persons who served in the capacity of director or senior executive officer during the year ended December 31, 2004 is as follows:

	2002		2003		2004	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at the beginning of the year	1,078,634	\$ 8.13	1,235,686	\$ 7.58	1,526,702	\$ 7.48
Adjustments to opening balance					(39,600)	
Granted	230,052	\$ 2.85	325,500	\$ 6.64	531,250	11.77
Cancelled	-	-	-	-	-	-
Exercised	(73,000)	\$ 0.86	(34,484)	\$ 3.09	(108,917)	5.16
Outstanding at the end of the year	1,235,686	\$ 7.58	1,526,702	\$ 7.48	1,909,435	9.11

As of December 31, 2004, options to purchase 902,644 ordinary shares were exercisable at an average exercise price of \$9.67 per share.

C. BOARD PRACTICES

Independent Directors; Audit Committee; Internal Auditor

Under the Israeli Companies Law, Israeli companies that have offered securities to the public in or outside of Israel are required to appoint at least two "outside" directors. Doron Nevo and Dr. Eyal Kishon are our outside directors. Under the requirements for listing on The Nasdaq National Market, we will be required by July 31, 2005 to have a majority of our directors be independent as defined by Nasdaq rules. Doron Nevo, Dr. Eyal Kishon, Dana Gross and Joeseph Tenne are independent directors for purposes of the Nasdaq rules.

To qualify as an outside director under Israeli law, an individual or his affiliates may not have, and may not have had at any time during the previous two years, any affiliation with the company or its affiliates, as such terms are defined in the Companies Law. In addition, no individual may serve as an outside director if the individual's position or other activities create or may create a conflict of interest with his or her role as an outside director or are likely to interfere with his or her ability to serve as a director. For a period of two years from termination from office, a former outside director may not serve as a director or employee of the company or provide professional services to the company for consideration.

The outside directors must be elected by the shareholders, including at least one-third of the shares of non-controlling shareholders voted on the matter. However, the outside directors can be elected by shareholders without this one-third approval if the total shares of non-controlling shareholders voted against the election do not represent more than one percent of the voting rights in the company. The term of an outside director is three years and may be extended for one additional three-year term. An outside director can be removed from office only under very limited circumstances. Each committee of a company's board of directors is required to include at least one outside director. If, at the time outside directors are elected, all current members of the board of directors are of the same gender, then at least one outside director must be of the other gender.

Under the Companies Law and the requirements for listing on The Nasdaq National Market, our board of directors is required to appoint an audit committee. The audit committee must be comprised of at least three directors, including all of the outside directors. The audit committee consists of three members: Dr. Eyal Kishon, Doron Nevo and Joseph Tenne. The audit committee may not include the chairman of the board, a controlling shareholder and the members of his immediate family, or any director who is employed by the company or provides services to the company on a regular basis. Under Israeli law, the role of the audit committee is to examine flaws in our business management, in consultation with the internal auditor and the independent accountants, and to propose remedial measures to the board. The audit committee also reviews for approval transactions between the company and office holders or interested parties, as described below.

Under the Companies Law, our board of directors is also required to appoint an internal auditor proposed by the audit committee. The internal auditor may be our employee, but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of our independent accounting firm. The role of the internal auditor is to examine, among other things, whether our activities comply with the law and orderly business procedure. Eitan Hashachar CPA has been our internal auditor since January 2001.

Our board of directors appointed Dr. Eyal Kishon and Dana Gross to serve on the compensation committee of the board of directors.

Pursuant to our articles of association, our directors were classified into three classes (classes I, II and III). The members of each class of directors and the expiration of the term of office is as follows:

Dana Gross	Class I	2007
Joseph Tenne	Class II	2005
Shabtai Adlersberg	Class III	2006

Our outside directors under the Companies Law, Doron Nevo and Dr. Eyal Kishon, are not members of any class and serve in accordance with the provisions of the Companies Law. Mr. Nevo's term ends in 2006 and Dr. Kishon's term ends in 2005.

D. EMPLOYEES

As of December 31, 2004, we employed a total of 445 persons worldwide, including 213 in research and development, 144 in selling and marketing, technical service and support, 25 in management and administration and 63 in operations. 105 of our employees are based in the United States, primarily in Somerset, New Jersey, 2 in Latin America, 3 in Europe, 13 in China one in India and one in Japan. In addition, as of December 31, 2004, we employed an additional 24 part-time employees. The growth in the number of employees during 2004 was attributable mainly to additions to our personnel resulting from the acquisition of Ai-Logix and to growth in our research and development and sales personnel.

As of December 31, 2003, we employed a total of 328 persons worldwide, including 145 in research and development, 119 in sales and marketing, technical service and support, 19 in management and administration and 45 in operations. Fifty of our employees are based in the United States, primarily in Raleigh, North Carolina, one in Japan, one in the United Kingdom, one in France and 10 in Beijing, China. In addition, as of December 31, 2003, we employed an additional 24 part-time employees. The growth in the number of employees during 2003 was attributable mainly to growth in our research and development team, and sales personnel.

As of December 31, 2002, we employed a total of 278 persons worldwide, including 137 in research and development, 84 in sales and marketing, technical service and support, 18 in management and administration and 39 in operations. 32 of our employees are based in the United States, primarily in San Jose, California, one in Japan and 8 in Beijing, China. In addition, as of December 31, 2002, we employed an additional 22 part-time employees. The growth in the number of employees during 2002 was attributable mainly to growth in our research and development teams, sales and sales support personnel.

Israeli labor laws and regulations are applicable to our employees in Israel. These laws principally concern matters such as paid annual vacation, paid sick days, length of the workday, pay for overtime, insurance for work-related accidents, severance pay and other conditions of employment. Israeli law generally requires severance pay, which may be funded by Manager's Insurance, described below, upon the retirement or death of an employee or termination of employment without cause (as defined under Israeli law). Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 16.3% of wages, of which the employee contributes approximately 64% and the employer contributes approximately 36%.

Although not legally required, we regularly contribute to a “Manager’s Insurance” fund or to a privately managed pension fund on behalf of our employees located in Israel. These funds provide employees with a lump sum payment upon retirement (or a pension, in case of a pension fund) and severance pay, if legally entitled thereto, upon termination of employment. We provide for payments to a Manager’s Insurance Fund and pension fund contributions in the amount of 13.3% of an employee’s salary on account of severance pay and provident payment or pension, with the employee contributing 5.0% of his salary. We also pay an additional amount of up to 2.5% of certain of our employees’ salaries in connection with disability payments. In addition, we administer an Education Fund for our Israeli employees and pay 7.5% of these employees’ salaries thereto, with the employees contributing 2.5% of their salary.

Furthermore, our employees are subject to certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists Associations) by order of the Israeli Ministry of Labor and Welfare. These provisions principally concern cost of living increases, recreation pay and other conditions of employment. We generally provide our employees with benefits and working conditions above the required minimums. Our employees, as a group, are not currently represented by a labor union. To date, we have not experienced any work stoppages.

E. SHARE OWNERSHIP

The following table sets forth the share ownership and outstanding number of options of our directors and officers as of March 31, 2005:

Name	Total Shares Beneficially Owned	Percentage of Ordinary Shares	Number of Options
Shabtai Adlersberg	5,033,102	12.6	633,718
Nachum Falek	*		*
Eyal Frishberg	*		*
Eli Nir	*		*
Lior Aldema	*		*
Ben Rabinowitz	*		*
Yehuda Hershkowitz	*		*
Tal Dor	*		*
Gary Drutin	*		*
Moshe Tal	*		*
Joseph Tenne	*		*
Dana Gross	*		*
Dr. Eyal Kishon	*		*
Doron Nevo	*		*

*Less than one percent.

The officers and directors have the same voting rights as the other shareholders.

The following table sets forth information with respect to the options to purchase our ordinary shares held by Mr. Adlersberg as of March 31, 2005.

Shabtai Adlersberg

Number of Options	Grant Date	Exercise Price	Exercised	Cancelled	Vesting	Expiration Date
96,000	July 1, 1996	\$ 0.61	(96,000)	-	4 years	July 1, 2006
96,000	July 1, 1998	\$ 1.10	(72,000)	-	4 years	July 1, 2008
100,000	May 23, 2000	\$29.16	-	-	4 years	May 23, 2007
225,000	December 19, 2001	\$ 4.18	-	-	4 years	December 19, 2008
9,718	August 9, 2002	\$ 2.04	-	-	2 years	August 9, 2009
275,000	September 23, 2004	\$12.84	-	-	4 years	September 23, 2011

Employee Share Plans

We have an Employee Share Purchase Plan and Employee Share Option Plans for the granting of options to our employees, officers, directors and consultants and adopted the 2001 U.S. Employee Stock Purchase Plans during 2001. Most of these plans are pursuant to the Israeli Income Tax Ordinance, entitling the beneficiaries who are our employees to tax benefits under Israeli law. There are various conditions that must be met in order to qualify for these benefits, including registration of the options in the name of a trustee for each of the beneficiaries who is granted options. Each option, and any ordinary shares acquired upon the exercise of the option, must be held by the trustee for a period commencing on the date of grant and ending no earlier than 24 months after the end of the tax year in which the option was granted and deposited in trust with the trustee. There are similar plans for our U.S. employees, which are designed to comply with the corresponding provisions of the Internal Revenue Code of 1986, as amended.

Employee Share Purchase Plans

We implemented two Employee Share Purchase Plans in May 2001. One plan is for our U.S. and Mexico employees and the other for all our Israeli and other employees. Under these Plans an aggregate of 2,000,000 of our ordinary shares were reserved for sale to our employees at a price equal to 85% of the lesser of fair market value on the first day or last day of each offering period under the Plans. As of December 31, 2004, we had issued 708,964 of our ordinary shares pursuant to purchases under these plans.

Employee Share Option Plans

In 1999, our board restated three 1997 Employee Share Option Plans for our Israeli employees, officers, directors and consultants and two 1997 Share Option Plans for our U.S. employees, officers, directors and consultants. Additionally, in 1999 our board adopted an Employee Share Option Plan for our Israeli employees, officers, directors and consultants, and an Employee Share Option Plan for our U.S. employees, officers, directors and consultants. The terms of the 1999 Plans are substantially the same as those of the 1997 Plans, but have reduced the exercise period from 10 to 7 years. The board has the ability to grant options with longer or shorter terms. The terms of the 1999 Plans have been modified slightly since they were adopted and in 2003, the Israeli Plan was changed to conform to amendments to the Israeli income tax law.

As of December 31, 2004, options to purchase a total of 6,534,669 shares are outstanding under the 1997 and 1999 Israeli Plans and options to purchase a total of 1,359,631 shares are outstanding under the 1997 U.S. Plan. In addition, a reserve of 561,000 shares has been made available for grant under the 1999 Israeli Plan and a reserve of 627,500 shares has been made available for grant under the 1999 U.S. Plan. However, subject to our board deciding otherwise, each year on July 1, starting with July 1999, the number of shares that will be made available for grant under both of the 1999 Plans, will be automatically increased to that number of shares that is equal to 5% of our outstanding share capital on such a date.

The holders of options under all of the plans are responsible for all personal tax consequences relating to the options. The exercise prices of the options are based on the fair value of the ordinary shares at the time of grant as determined by our board of directors. The board considers many factors in establishing such prices, including our financial condition and operating results, investors' valuations and the market for the securities of comparable industry group companies.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

To our knowledge, (A) we are not directly or indirectly owned or controlled (i) by another corporation or (ii) by any foreign government and (B) there are no arrangements, the operation of which may at a subsequent date result in a change in control of AudioCodes. The following table sets forth, as of December 31, 2004, the number of our ordinary shares, which constitute our only voting securities, beneficially owned by (i) all shareholders known to us to own more than 5% of our outstanding ordinary shares, and (ii) all of our directors and senior executive officers as a group.

Identity of Person or Group	Amount Owned	Percent of Class
Shabtai Adlersberg ⁽¹⁾	5,334,328	13.4%
Leon Bialik ⁽²⁾	3,928,222	9.9%
FMR Corp. ⁽³⁾	3,275,764	8.2%
Kern Capital ⁽⁴⁾	2,674,100	6.7%
All directors and senior executive officers as a group (14 persons) ⁽⁵⁾	831,775	2.1%

(1) Includes options to purchase 302,468 shares, which may be purchased pursuant to options exercisable within sixty days following December 31, 2004.

(2) The information is derived from a statement on Schedule 13G/A, dated February 14, 2005 of Leon Bialik filed with the Securities and Exchange Commission.

- (3) The information is derived from the joint statement on Schedule 13G/A, dated February 14, 2005, of FMR Corp., Edward C. Johnson 3d, Abigail P. Johnson, and Fidelity Management & Research Company filed with the Securities and Exchange Commission. The address of FMR Corp. is 82 Devonshire Street, Boston, Massachusetts 02109.
- (4) The information is derived from a statement on Schedule 13G, dated February 14, 2005 of Kern Capital Management, Robert E. Kern Jr. and David G. Kern filed with the Securities and Exchange Commission.
- (5) Includes 621,209 ordinary shares, which may be purchased pursuant to options exercisable within sixty days following December 31, 2004.

During 2004, Mr. Adlersberg acquired 93,421 of our ordinary shares and Mr. Bialik sold 421,500 of our ordinary shares. During 2003, Mr. Adlersberg acquired 285,130 of our ordinary shares and Mr. Bialik sold 208,000 of our ordinary shares. During 2002, Mr. Adlersberg acquired 10,265 of our ordinary shares and Mr. Bialik did not sell or acquire any of our ordinary shares.

FMR Corp. held 8.2% of our ordinary shares as of December 31, 2004, as compared to 7.3% of our ordinary shares as of December 31, 2003 and 10.2% of our ordinary shares as of December 31, 2002. Kern Capital held 6.7% of our ordinary shares as of December 31, 2004, as compared to less than 5% of our ordinary shares as of December 31, 2003.

As of March 31, 2005, there were approximately 25 holders of record of our ordinary shares in the United States, although we believe that the number of beneficial owners of the ordinary shares is significantly greater. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees.

The major shareholders have the same voting rights as the other shareholders.

B. RELATED PARTY TRANSACTIONS

In October 1999, we entered into a development agreement with DSP Group Ltd., a company affiliated with DSP Group, Inc., and a third party. According to the agreement, DSP Group Ltd. will pay royalties for every chip actually sold by DSP Group Ltd. to third parties. During 2004, DSP Group, Inc. sold all its holdings in our shares.

We recorded revenues related to this agreement in a total amount of \$209,000 in 2002, \$261,000 in 2003 and \$47,000 in 2004. In addition, we purchased from DSP Group Ltd. raw material in a total amount of \$19,000 in 2002 and \$15,000 in 2003.

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

See Item 18.

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

Our ordinary shares are listed on the Nasdaq National Market and The Tel Aviv Stock Exchange under the symbol "AUDC."

In accordance with Rule 4350(a)(1) of the Rules of Corporate Governance of The Nasdaq Stock Market, Inc., we have received an exemption from the requirement to distribute an annual report to our shareholders prior to our annual meeting of shareholders. The basis for the exemption is that the generally accepted business practice in Israel, where we are incorporated, is not to distribute an annual report to shareholders. We post our Annual Report on Form 20-F on our web site (www.audiocodes.com) as soon as practical following the filing of the Annual Report on Form 20-F with the Securities and Exchange Commission.

The following table sets forth, for the periods indicated, the high and low sales prices of our ordinary shares as reported by the Nasdaq National Market. All per share prices for periods prior to or including October 6, 2000 have been retroactively adjusted to reflect the two-for-one stock split effected on that date.

Calendar Year	Price Per Share	
	High	Low
2004	\$ 16.88	\$ 8.48
2003	\$ 11.74	\$ 2.10
2002	\$ 5.91	\$ 1.61
2001	\$ 25.75	\$ 1.60
2000	\$ 76.00	\$ 9.25

Calendar Period	Price Per Share	
	High	Low
2005		
Second quarter (through May 31, 2005)	\$ 12.15	\$ 8.67
First quarter	\$ 17.00	\$ 10.66
2004		
Fourth quarter	\$ 16.88	\$ 11.85
Third quarter	\$ 13.97	\$ 9.51
Second quarter	\$ 12.98	\$ 8.48
First quarter	\$ 16.10	\$ 10.35
2003		
Fourth quarter	\$ 11.74	\$ 7.59
Third quarter	\$ 8.85	\$ 4.40
Second quarter	\$ 5.80	\$ 2.65
First quarter	\$ 2.71	\$ 2.10

Calendar Month	Price Per Share	
	High	Low
2005		
May	\$ 12.15	\$ 9.78
April	\$ 11.46	\$ 8.67
March	\$ 13.69	\$ 10.66
February	\$ 15.49	\$ 12.10
January	\$ 17.00	\$ 14.12
2004		
December	\$ 16.88	\$ 14.60

The following table sets forth, for the periods indicated, the high and low sales prices of our ordinary shares as reported by The Tel Aviv Stock Exchange. Our shares commenced trading on The Tel Aviv Stock Exchange on October 21, 2001. All share prices shown in the following table are in NIS. As of December 31, 2004, the exchange rate was equal to approximately 4.308 NIS per U.S. \$1.00.

Calendar Year	Price Per Share	
	High	Low
2004	NIS 74.90	NIS 39.10
2003	NIS 53.50	NIS 10.42
2002	NIS 26.94	NIS 7.41
2001 (commencing October 21, 2001)	NIS 26.90	NIS 10.25

Calendar Period

Price Per Share

	Price Per Share	
	High	Low
2005		
Second quarter (through May 31, 2005)	NIS 53.97	NIS 40.20
First quarter	NIS 73.80	NIS 46.91
2004		
Fourth quarter	NIS 70.00	NIS 52.12
Third quarter	NIS 57.93	NIS 43.00
Second quarter	NIS 57.10	NIS 39.10
First quarter	NIS 74.90	NIS 46.01
2003		
Fourth quarter	NIS 53.50	NIS 33.30
Third quarter	NIS 38.45	NIS 19.80
Second quarter	NIS 24.00	NIS 12.50
First quarter	NIS 12.59	NIS 10.42

Calendar Month

Price Per Share

	Price Per Share	
	High	Low
2005		
May	NIS 53.97	NIS 43.00
April	NIS 50.38	NIS 40.20
March	NIS 59.68	NIS 46.91
February	NIS 66.54	NIS 56.24
January	NIS 73.80	NIS 62.40
2004		
December	NIS 70.00	NIS 63.09

B. *PLAN OF DISTRIBUTION*

Not applicable.

C. *MARKETS*

Our ordinary shares are listed for trading on the Nasdaq National Market under the symbol "AUDC". Our ordinary shares are also listed for trading on The Tel-Aviv Stock Exchange under the symbol "AUDC". In addition, we are aware of our ordinary shares being traded on the following markets: Frankfurt Stock Exchange, Berlin Stock Exchange, Munich Stock Exchange and XETRA.

D. *SELLING SHAREHOLDERS*

Not applicable.

E. *DILUTION*

Not applicable.

F. EXPENSES OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Objects and Purposes

Our registration number with the Israeli Registrar of Companies is 520044132. Our objects and purposes, set forth in Section 2 of our memorandum of association, are:

- to plan, develop and market voice signal systems;
- to purchase, import, market and wholesale and retail distribute, in Israel and abroad, consumption goods and accompanying products;
- to serve as representatives of bodies, entrepreneurs and companies from Israel and abroad with respect to their activities in Israel and abroad; and
- to carry out any activity as determined by the lawful management.

Borrowing Powers

The board of directors has the power to cause us to borrow money and to secure the payment of borrowed money. The board of directors specifically has the power to issue bonds or debentures, and to impose mortgages or other security interests on all or any part of our property.

Amendment of Articles of Association

Shareholders may amend our articles of association by a resolution adopted at a shareholders meeting by the holders of 50% of voting power represented at the meeting in person or by proxy and voting thereon.

Dividends

We may pay dividends only out of our profits. The amount of any dividend to be distributed among shareholders is based on the nominal value of their shares. Our board of directors has determined that any tax-exempt income attributable to the approved enterprise will not be distributed as dividends.

Voting Rights and Powers

Unless any shares have special rights as to voting, every shareholder has one vote for each share held of record. A shareholder is not entitled to vote at any shareholders meeting unless all calls then payable by him in respect of his shares have been paid (this does not apply to separate meetings of the holders of a particular class of shares with respect to the modification or abrogation of their rights).

Under our articles of association, we may issue preferred shares from time to time, in one or more series. However, in connection with our listing on The Tel-Aviv Stock Exchange in 2001, we agreed that for such time as our ordinary shares are traded on The Tel-Aviv Stock Exchange, we will not issue any of the 2,500,000 preferred shares, nominal value NIS 0.01, authorized in our articles of association. Notwithstanding the foregoing, we may issue preferred shares if the preference of those shares is limited to a preference in the distribution of dividends and such preferred shares have no voting rights.

Business Combinations

Our articles of association impose restrictions on our ability to engage in any merger, asset or share sale or other similar transaction with a shareholder holding 15% or more of our voting shares.

Winding Up

Upon our liquidation, our assets available for distribution to shareholders will be distributed to them in proportion to the nominal value of their shares.

Redeemable Shares

We may issue and redeem redeemable shares.

Modification of Rights

Subject to the provisions of our memorandum of association, and without prejudice to any special rights previously conferred upon the holders of our existing shares, we may, from time to time, by a resolution approved by the holders of 50% voting power represented at the meeting in person or by proxy and voting thereon, provide for shares with such preferred or deferred rights or rights of redemption, or other special rights and/or such restrictions, whether in regard to dividends, voting repayment of share capital or otherwise, as may be stipulated in such resolution.

If at any time our share capital is divided into different classes of shares, we may modify or abrogate the rights attached to any class, unless otherwise provided by the articles of association, by a resolution approved by the holders of 50% voting power represented at the meeting in person or by proxy and voting thereon, subject to the consent in writing of the holders of 75% of the issued shares of that class.

The provisions of our articles of association relating to general meetings also apply to any separate general meeting of the holders of the shares of a particular class, except that two or more members holding not less than 75% of the issued shares of that class must be present in person or by proxy at that separate general meeting for a quorum to exist.

Unless otherwise provided by our articles of association, the increase of an authorized class of shares, or the issuance of additional shares thereof out of the authorized and unissued share capital, shall not be deemed to modify or abrogate the rights attached to previously issued shares of that class or of any other class.

Shareholders Meetings

An annual meeting of shareholders is to be held once a year, within 15 months after the previous annual meeting. The annual meeting may be held in Israel or outside of Israel, as determined by the board of directors.

The board of directors may, whenever it thinks fit, convene a special shareholders meeting. The board must convene a special shareholders meeting at the request of:

- at least two directors;
- at least one-quarter of the directors in office; or
- shareholders who hold at least 5% of the outstanding equity and at least 1% of the voting rights, or at least 5% of the outstanding voting rights.

A special shareholders meeting may be held in Israel or outside of Israel, as determined by the board of directors.

Notice of General Meetings; Omission to Give Notice

The provisions of the Companies Law and the related regulations override the provisions of our articles of association, and provide for notice of a meeting of shareholders to be sent to each registered shareholder at least 21 days in advance of the meeting. Notice of a meeting of shareholders must also be published in two Israeli newspapers prior to the record date for the meeting.

Notice of a meeting of shareholders must specify the type of meeting, the place and time of the meeting, the agenda, a summary of the proposed resolutions, the majority required to adopt the proposed resolutions, and the record date for the meeting. The notice must also include the address and telephone number of our registered office, and a list of times at which the full text of the proposed resolutions may be examined at the registered office.

The accidental omission to give notice of a meeting to any shareholder, or the non-receipt of notice sent to such shareholder, does not invalidate the proceedings at the meeting.

Limitations on Foreign Shareholders to Hold or Exercise Voting Rights

There are no limitations on foreign shareholders in our articles of association. Israeli law restricts the ability of citizens of countries that are in a state of war with Israel to hold shares of Israeli companies.

Approval of Transactions under Israeli Law

The Companies Law imposes fiduciary duties that “office holders,” including directors and executive officers, owe to their company. An office holder’s fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care generally requires an office holder to act with the level of care which a reasonable office holder in the same position would have acted under the same circumstances. The duty of loyalty generally requires an office holder to act in good faith and for the good of the company. Specifically, an office holder must avoid any conflict of interest between the office holder’s position in the company and his or her other positions or personal affairs. In addition, an office holder must avoid competing against the company or exploiting any business opportunity of the company for his or her own benefit or the benefit of others. An office holder must also disclose to the company any information or documents relating to the company’s affairs that the office holder has received due to his or her position in the company. The term “office holder” includes any person who, either formally or in substance, serves as a director, general manager or chief executive officer, or who reports directly to the general manager or chief executive officer. Each person listed in the table under “Item 6. Directors, Senior Management and Employees–A. Directors and Senior Management” above is an “office holder” of AudioCodes.

Under the Companies Law, all arrangements as to compensation of office holders who are not directors require approval of the board of directors and, in certain cases, the prior approval of the audit committee. Arrangements as to compensation of directors also require audit committee and shareholder approval.

The Companies Law requires that an office holder promptly disclose any personal interest that he or she may have, and all related material information known to him or her, in connection with any existing or proposed transaction by the company. A personal interest of an office holder includes a personal interest of the office holder’s relative or a corporation in which the office holder or the office holder’s relative is a 5% or greater shareholder, director or general manager or has the right to appoint at least one director or the general manager. The office holder’s duty to disclose shall not apply in the event that the personal interest only results from a personal interest of the office holder’s relative in a transaction that is not an extraordinary transaction. An extraordinary transaction is a transaction not in the ordinary course of business, not on market terms, or likely to have a material impact on the company’s profitability, assets or liabilities.

For a transaction that is not an extraordinary transaction, under the Companies Law, once the office holder complies with the above disclosure requirement, the board of directors is authorized to approve the transaction, unless the articles of association provide otherwise. A transaction that is adverse to the company’s interest may not be approved. If the transaction is an extraordinary transaction, then it also must be approved by the company’s audit committee and board of directors, and, under certain circumstances, by the shareholders of the company. Generally, when an extraordinary transaction is considered by the audit committee and board of directors, the interested directors may not be present or vote.

Duties of Shareholders

Under the Companies Law, the disclosure requirements that apply to an office holder also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder that owns 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights, but excluding a shareholder whose power derives solely from his or her position on the board of directors or any other position with the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the engagement of a controlling shareholder as an office holder or employee, generally require the approval of the audit committee, the board of directors and the shareholders. The shareholder approval must include at least one-third of the shares of non-interested shareholders voted on the matter. However, the transaction can be approved by shareholders without this one-third approval if the total shares of non-interested shareholders voted against the transaction do not represent more than one percent of the voting rights in the company.

In addition, under the Companies Law, each shareholder has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his or her power in the company, such as in shareholder votes. In addition, specified shareholders have a duty of fairness toward the company. These shareholders include any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder who, pursuant to the provisions of the articles of association, has the power to appoint an office holder or any other power with respect to the company. A recent amendment to the Companies Law provides that a breach of the duty of fairness will be governed by the laws governing breach of contract. However, the Companies Law does not define the substance of this duty of fairness.

Israeli law permits a company to insure an office holder in respect of liabilities incurred by the office holder as a result of:

- the breach of his or her duty of care to the company or to another person, or
- as a result of the breach of his or her fiduciary duty to the company,

to the extent that the office holder acted in good faith and had reasonable cause to believe that the act would not prejudice the company. A company can also insure an office holder against monetary liabilities as a result of an act or omission that the office holder committed in connection with his or her serving as an office holder.

Moreover, a company can indemnify an office holder for any of the following obligations or expenses incurred in connection with his or her acts or omissions as an office holder:

- monetary liability imposed upon the office holder in favor of other persons pursuant to a court judgment, including a compromise judgment or an arbitrator's decision approved by a court;
- reasonable litigation expenses, including attorney's fees, incurred by the office holder as a result of an investigation or proceeding instituted against the office holder by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any financial liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a financial liability was imposed on the office holder in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court, in an action, suit or proceeding brought against the office holder by or on behalf of the company or other persons; in a criminal action in which the office holder was acquitted; or in a criminal action which does not require criminal intent in which the office holder was convicted. A company may also exculpate an office holder in advance, in whole or in part, from liability for damages sustained by a breach of duty of care to the company.

Furthermore, a company can, with one limited exception, exculpate an office holder in advance, in whole or in part, from liability for damages sustained by a breach of duty of care to the company.

Our articles of association allow us to insure, indemnify and exculpate office holders to the fullest extent permitted by law, provided such insurance or indemnification is approved in accordance with law.

We have entered into an undertaking to indemnify our office holders in specified limited categories of events and in specified amounts, subject to certain limitations. This undertaking has been ratified by our audit committee, board of directors and shareholders. We have acquired directors' and officers' liability insurance covering our officers and directors and the officers and directors of our subsidiaries against certain claims.

C. MATERIAL CONTRACTS

On November 3, 2004, we entered into a purchase agreement with Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Lehman Brothers Inc. and CIBC World Markets Corp., with respect to the issue and sale of \$100.0 million aggregate principal amount of our 2.00% Senior Convertible Notes due 2024 and the grant of an option for the purchase of an additional \$25.0 million aggregate principal amount of our notes, which was exercised in full on November 16, 2004.

On November 9, 2004, we entered into an indenture with U.S. Bank National Association in connection with the issuance of our 2.00% Senior Convertible Notes due 2024. The indenture provides that the notes are senior, unsecured obligations of AudioCodes Ltd. Pursuant to the indenture, the notes accrue interest at a rate of 2.00% per annum, payable semi-annually on May 9 and November 9 of each year, with a final maturity on November 9, 2024. The indenture provides that the notes may be redeemed by us, in whole or in part, at any time after November 9, 2009, and that the holders of the notes may require us to redeem the notes on November 9, 2009, November 9, 2014 or November 9, 2019, or upon certain fundamental changes. If any notes are redeemed prior to November 9, 2009 based on certain fundamental changes, we will also be required to make a 'make-whole' premium payment to the redeeming note holders. Under the terms of the indenture and the notes, holders of the notes are entitled to convert the notes into our ordinary shares at a conversion rate of 53.4474 ordinary shares per \$1,000 principal amount of notes, which is the equivalent to a conversion price of approximately \$18.71 per share. The conversion rate is subject to adjustment in certain circumstances, such as changes in our capital structure or upon the issuance by us of share dividends or certain cash distributions.

On November 9, 2004, we also entered into a registration rights agreement with Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Lehman Brothers Inc. and CIBC World Markets Corp., pursuant to which we agreed to file with the U.S. Securities and Exchange Commission within 150 days of November 9, 2004, a shelf registration statement covering our 2.00% Senior Convertible Notes due 2024 and shares issuable upon conversion of the notes, and to maintain the effectiveness of the registration statement until the earlier of the date on which all the shares have been resold under the registration statement, the date of expiration of the holding period under applicable law that would enable the resale of the shares without restriction or registration under applicable law, or November 16, 2006. Under the terms of the registration rights agreement, if either (i) on the day following the filing deadline, the shelf registration statement has not been filed with the SEC; (ii) on the 211th day following the earliest date of original issuance of any of the notes, the shelf registration statement is not declared effective, (iii) the registration statement ceases to be effective or fails to be usable without being succeeded within five business days by a post-effective amendment or a report filed with the SEC pursuant to the Exchange Act that cures the failure of the registration statement to be effective or usable or (iv) the prospectus has been suspended for more than 60 days (or more than 90 days in any twelve month period), then additional interest will accrue on our notes beginning on the day following such triggering event through the day on which the triggering event has been cured. The additional interest will accrue at a rate of 0.25% for the first ninety days of the triggering event, and 0.5% thereafter.

On May 12, 2004, we acquired the outstanding shares of capital stock of Ai-Logix, Inc. See Item 4A for a summary of material terms of the Stock Purchase Agreement between us, AudioCodes Inc., Ai-Logix and AI Technologies N.V.

On April 7, 2003, we purchased selected assets of Nortel Networks Universal Audio Server business. See Item 4A for a summary of material terms of our Asset Purchase Agreement with Nortel Networks.

In connection with our acquisition of Nortel Networks Universal Audio Server business, we also entered into an OEM Purchase and Sale Agreement with Nortel Networks on April 28, 2003, under which we agreed to supply Nortel Networks with certain Universal Audio Server products at specified prices for a duration of at least three years.

Since January 1, 2003, all exchange control restrictions imposed by the State of Israel have been removed, although there are still reporting requirements for foreign currency transactions. However, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time. Nonresidents of Israel who purchase our ordinary shares are able to receive any dividends thereon (and any amounts payable upon the dissolution, liquidation and winding up of our affairs) freely repatriable in non-Israeli currency, provided that Israeli income tax has been paid or withheld on such amounts (see “Item 10. Additional Information–E. Taxation–Israeli Tax Considerations–Tax on Dividends”).

Non-residents of Israel may freely hold and trade our ordinary shares, and the proceeds of sale thereof are not subject to Israeli currency control restrictions. Our memorandum of association and articles of association do not restrict in any way the ownership of ordinary shares by non-residents of Israel and neither our memorandum of association and articles of association nor Israeli law restricts the voting rights of non-residents, except with respect to citizens of countries that are in a state of war with Israel.

E. TAXATION

The following is a summary of the material Israeli and United States tax consequences, Israeli foreign exchange regulations and certain Israeli government programs affecting us. To the extent that the discussion is based on new tax or other legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax or other authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice, is not exhaustive of all possible tax considerations and should not be relied upon for tax planning purposes.

Israeli Tax Considerations

Tax Reform in Israel

On January 1, 2003, the Law for Amendment of the Income Tax Ordinance (Amendment No.132), 2002, or the Tax Reform, came into effect, following its enactment by the Israeli Parliament on July 24, 2002. On December 17, 2002, the Israeli Parliament approved a number of amendments to the Tax Reform, which came into effect on January 1, 2003. Other regulations and decrees relating to the Tax Reform were executed as well.

The Tax Reform, aimed at broadening the categories of taxable income and reducing the tax rates imposed on employment income, introduced the following, among other things:

- Reduction of the tax rate levied on capital gains (other than gains deriving from the sale of listed securities) derived after January 1, 2003, to a general rate of 25% for both individuals and corporations. Regarding assets acquired prior to January 1, 2003, the reduced tax rate will apply to a proportionate part of the gain, in accordance with the holding periods of the asset, before or after January 1, 2003, on a linear basis;

- Imposition of Israeli tax on all income of Israeli residents, individuals and corporations, regardless of the territorial source of income, including income derived from passive sources such as interest, dividends and royalties;
- Introduction of controlled foreign corporation (CFC) rules into the Israeli tax structure. Generally under such rules, an Israeli resident who holds, directly or indirectly, 10% or more of the rights in a foreign corporation whose shares are not publicly traded, in which more than 50% of rights are held directly or indirectly by Israeli residents, which has undistributed profits and a majority of whose income in a tax year is considered passive income, will be liable for tax on the portion of such income attributed to his holdings in such corporation, as if such income were distributed to him as a dividend;
- Imposition of capital gains tax on capital gains realized by individuals as of January 1, 2003, from the sale of shares of publicly traded companies (which was previously exempt from capital gains tax in Israel). For information with respect to the applicability of Israeli capital gains taxes on the sale of ordinary shares, see “*Capital Gains Tax Applicable to Resident and Non-Resident Shareholders*” below;
- Introduction of a new regime for the taxation of shares and options issued to employees and officers (including directors).

General Corporate Tax Structure

Israeli companies are generally subject to corporate tax on their taxable income at a rate of 35% (in the 2004 tax year), 34% (in the 2005 tax year), 32% (in the 2006 tax year) and 30% (in and after the 2007 tax year). However in our case, the rate is currently effectively reduced, as described below.

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

Our facilities have been granted approved enterprise status pursuant to the Law for the Encouragement of Capital Investments, 1959 or the Investment Law, which provides certain tax and financial benefits to investment programs that have been granted such status.

The Investment Law provides that a proposed capital investment in eligible facilities may be designated as an “approved enterprise.” Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program. The tax benefits under the Investment Law are not available for income derived from products manufactured outside of Israel.

A company owning an approved enterprise may elect to receive either governmental grants or an alternative package of tax benefits. Under the alternative package, a company's undistributed income derived from an approved enterprise will be exempt from corporate tax for a period of two to ten years (depending on the geographic location of the approved enterprise within Israel). The exemption commences in the first year of taxable income, and the company is taxed at a reduced corporate rate of 10% to 25% for the following five to eight years, depending on the extent of foreign shareholders' ownership of the company's ordinary shares. The benefits period is limited to twelve years from completion of the investment under the approved plan or fourteen years from the date of approval, whichever is earlier. A Foreign Investors Company, or FIC, defined in the Investment Law as a company of which more than 25% of its shareholders are non-Israeli residents, may enjoy benefits for a period of up to ten years, or twelve years if it complies with certain export criteria stipulated in the Investment Law (the actual length of the benefits period is graduated based on the percentage of foreign ownership).

The tax benefits derived from any certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates.

Our production facilities have been granted the status of approved enterprise. Income arising from our approved enterprise facilities is tax-free under the alternative package of benefits described above and entitled to reduced tax rates based on the level of foreign ownership for specified periods. We have derived, and expect to continue to derive, a substantial portion of our operating income from our approved enterprise facilities. The tax benefits attributable to our current approved enterprises are scheduled to expire gradually from 2007 to 2014.

Distribution of earnings derived from approved enterprise which were previously taxed at reduced tax rates, would not result in additional tax consequences to us. However, if retained tax-exempt income is distributed in a manner, we would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%). We are not obliged to distribute exempt retained earnings under the alternative package of benefits, and may generally decide from which source of income to declare dividends. We currently intend to reinvest the amount of our tax-exempt income and not to distribute such income as a dividend. Dividends from approved enterprises are generally taxed at a rate of 15% (which is withheld and paid by the company paying the dividend) if such dividend is distributed during the benefits period or within twelve years thereafter. The twelve-year limitation does not apply to an FIC.

Future approved enterprises will be reviewed separately, and the decisions whether to approve or reject a designation as an approved enterprise will be based, among other things, on the criteria set forth in the Investment Law and related regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the company. Accordingly, there can be no assurance that any new investment programs will be approved as approved enterprises. In addition, the benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investment Law and related regulations and the criteria set forth in the specific certificate of approval. In the event that a company does not meet these conditions, it will be subject to corporate tax at the rate then in effect under Israeli law for such tax year. As of December 31, 2004, management believes that we meet all of the aforementioned conditions. A comprehensive amendment of the Investment Law has recently been approved by the Knesset. The amendment imposes additional eligibility criteria for approved enterprise benefits. The amendment also offers additional forms of alternative benefits. We do not believe that the amendment would have a material effect on us.

Law for the Encouragement of Industrial Research and Development, 1984

Under the Law for the Encouragement of Industrial Research and Development, 1984 and the related regulations, or the Research Law, research, development and pre-manufacturing programs that meet specified criteria and are approved by a governmental committee (the Research Committee) of the Office of Chief Scientist (OCS) are eligible for grants of up to 50% of the expenditures on the program. Each application to the OCS is reviewed separately, and grants are based on the program approved by the Research Committee. Expenditures supported under other incentive programs of the State of Israel are not eligible for OCS grants. As a result, we cannot be sure that applications to the OCS will be approved or, if approved, that we will receive the amounts for which we apply.

Recipients of these grants are required to pay royalties on the revenues derived from the sale of product developed in accordance with the program. The royalties are payable at the rate of 3% of revenues during the first three years, 4% of revenues during the following three years, and 5% of revenues in the seventh year and thereafter, with the total royalties not to exceed 100% of the dollar value of the OCS grant.

The terms of the Israeli government participation require that products developed with OCS grants must generally be manufactured in Israel. If we receive OCS approval for any portion of this manufacturing to be performed outside of Israel, the royalty rate would be increased and the repayment schedule would be accelerated, based on the extent of the manufacturing conducted outside of Israel. Depending upon the extent of the manufacturing volume that is performed outside of Israel, the ceiling on royalties would increase to 120%, 150% or 300% of the grant. Under an amendment to the Research Law effective June 7, 2005, the authority of the Research Committee to approve the transfer of manufacture outside of Israel was expanded.

The technology developed pursuant to the terms of these grants may not be transferred to third parties without the prior approval of the Research Committee. This approval is required only for the export of the technology, and not for the export of any products that incorporate the sponsored technology. Approval of the transfer of technology may be granted only if the recipient agrees to abide by all the provisions of the Research Law, including the restrictions on the transfer of know-how and the obligation to pay royalties in an amount that may be increased. The amendment to the Research Law effective June 7, 2005 granted authority to the Research Committee to approve the transfer of sponsored technology outside of Israel, subject to various conditions.

We have received grants from the OCS, and therefore we are subject to various restrictions under the Research Law on the transfer of technology or manufacturing. These restrictions do not terminate upon the full payment of royalties.

In order to meet specified conditions in connection with the grants and programs of the OCS, we have made representations to the Government of Israel about our Israeli operations. From time to time the conduct of our Israeli operations has deviated from our representations. If we fail to meet the conditions to grants, including the maintenance of a material presence in Israel, or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund the grants previously received (together with an adjustment based on the Israeli consumer price index and an interest factor) and would likely be ineligible to receive OCS grants in the future.

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

According to the Law for the Encouragement of Industry (Taxation), 1969, or the Industry Encouragement Law, an “industrial company” is a company resident in Israel, that at least 90% of its income, in any tax year (determined in Israeli currency, exclusive of income from certain government loans, capital gains, interest and dividends) is derived from an industrial enterprise owned by it. An industrial enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity. We currently believe that we qualify as an industrial company within the definition of the Industry Encouragement Law. Under the Industry Encouragement Law, industrial companies are entitled to the following preferred corporate tax benefits:

- deduction of purchases of know-how and patents over an eight-year period for tax purposes;
- the right to elect, under specified conditions, to file a consolidated tax return with related Israeli industrial companies; and
- accelerated depreciation rates on equipment and buildings.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. The Israeli tax authorities may determine that we do not qualify as an industrial company, which would entail our loss of the benefits that relate to this status. In addition, no assurance can be given that we will continue to qualify as an industrial company, in which case the benefits described above will not be available in the future.

Stamp Tax

Under Israel’s Stamp Tax on Documents Law, certain documents are subject to stamp tax. Recently promulgated regulations provide for a gradual phase-out of the stamp tax by 2008. In 2004, however, the tax authorities began an enforcement campaign involving extensive audits of companies’ compliance with the stamp tax obligation with respect to all agreements that had been signed since June 2003. We have recently received from the tax authorities a request for a list of all agreements signed since June 2003.

We have received legal advice that there are a variety of defenses relating to the obligation to pay stamp tax or to the amount to be paid. In addition, the Israeli Forum of CFOs has filed a petition with the Israeli Supreme Court against enforcement of the law, and this petition is currently pending. If the Forum of CFOs’ petition is rejected and the tax authorities do not accept our defenses, we may be liable to pay stamp tax with respect to the period beginning June 1, 2003. Our management believes that applicable provision in the financial statements as of December 31, 2004, is adequate to cover probable costs arising from this matter.

Special Provisions Relating to Measurement of Taxable Income

Until December 31, 2002, we measured our taxable income in accordance with the Income Tax Law (Inflationary Adjustments), 1985 or the Inflationary Adjustments Law, which represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Since January 1, 2003, we elected to measure our taxable income based on the changes in the exchange rate of the U.S. dollar rather than on the basis of inflation, based on our status as an FIC.

Capital Gains Tax Applicable to Resident and Non-Resident Shareholders

Israeli law generally imposes a capital gains tax on the sale of capital assets located in Israel, including shares in Israeli resident companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a treaty between Israel and the country of the non-resident provides otherwise. Regulations promulgated under the Israeli Income Tax Ordinance provided for an exemption from Israeli capital gains tax for gains accrued before January 1, 2003 and derived from the sale of shares of an industrial company, as defined by the Industry Encouragement Law, that are traded on specified non-Israeli markets, including The Nasdaq National Market, provided that the sellers purchased their shares either in the company's initial public offering or in public market transactions thereafter. This exemption does not apply to shareholders who are in the business of trading securities, or to shareholders that are Israeli resident companies subject to the Inflationary Adjustments Law. We believe that we are currently an industrial company, as defined by the Industry Encouragement Law. The status of a company as an industrial company may be reviewed by the tax authorities from time to time. There can be no assurance that the Israeli tax authorities will not deny our status as an industrial company, possibly with retroactive effect.

On January 1, 2003, the Tax Reform came into effect thus imposing capital gains tax at a rate of 15% on gains derived on or after January 1, 2003 from the sale of shares in Israeli companies:

- publicly traded on The Tel Aviv Stock Exchange, or the TASE;
- publicly traded on Nasdaq or a recognized stock exchange or regulated market in a country that has a treaty for the prevention of double taxation with Israel; or
- companies dually traded on both the TASE and on Nasdaq or a recognized stock exchange or a regulated market outside of Israel.

This tax rate does not apply to the sale of shares:

- to a relative (as defined in the tax reform);
- by dealers in securities;
- by shareholders that report in accordance with the Inflationary Adjustments Law; or
- by shareholders who acquired their shares prior to an initial public offering (that are subject to a different tax arrangement).

This tax rate is contingent upon the shareholder not claiming a deduction for financing expenses in connection with such shares.

Regulations adopted in connection with the Tax Reform deal with the taxation of the gain on securities acquired prior to the effectiveness of the Tax Reform and sold subsequent to the effectiveness of the Tax Reform (allocation of the gain as between the exempt period and the taxable period).

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares publicly traded on the TASE, provided such gains do not derive from a permanent establishment of such shareholders in Israel. Non-Israeli residents are also exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided that such capital gains are not derived from a permanent establishment in Israel and that such shareholders did not acquire their shares prior to the issuer's initial public offering. However, non-Israeli corporations will not be entitled to the exemption with respect to gains derived from the sale of shares of Israeli companies publicly traded on the TASE, if an Israeli resident (i) has a controlling interest of 25% or more 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 subject 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.

United States-Israel Tax Treaty

Pursuant to the Convention Between the Government of the United States of America and the Government of Israel with respect to Taxes on Income, as amended, or the United States-Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who holds the ordinary shares as a capital asset and who qualifies as a resident of the United States within the meaning of the United States- Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the United States-Israel Tax Treaty, or a Treaty United States Resident, generally will not be subject to the Israeli capital gains tax unless such Treaty United States Resident holds, directly or indirectly, shares representing 10% or more of the voting power of our company during any part of the twelve-month period preceding such sale, exchange or disposition, subject to certain conditions. A sale, exchange or disposition of shares by a Treaty United States Resident who holds, directly or indirectly, shares representing 10% or more of the voting power of our company at any time during such preceding twelve-month period would be subject to such Israeli tax, to the extent applicable; however, under the United States-Israel Tax Treaty, such Treaty United States Resident would be permitted to claim a credit for such taxes against the United States federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in United States laws applicable to foreign tax credits. The United States-Israel Tax Treaty does not relate to state or local taxes.

Tax on Dividends

Non-residents of Israel are subject to Israeli income tax on income accrued or derived from sources in Israel or received in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends, other than bonus shares and stock dividends, income tax at the rate of 25% is withheld at the source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. If the dividends are distributed out of approved enterprise earnings, the applicable tax rate would be 15%. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty United States Resident will be 25%, however that tax rate is reduced to 12.5% for dividends not generated by an approved enterprise to a corporation which holds 10% or more of the voting power of our company during a certain period preceding distribution of the dividend. Dividends derived from an approved enterprise will still be subject to 15% tax withholding.

Foreign Exchange Regulations

Dividends, if any, paid to the holders of the ordinary shares, and any amounts payable upon dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of the ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid or withheld on such amounts.

United States Tax Considerations

United States Federal Income Taxes

The following summary describes the material U.S. federal income tax consequences to "U.S. holders" (as defined below) arising from the purchase, ownership and disposition of our ordinary shares. This summary is based on current provisions of the Internal Revenue Code of 1986, as amended, or the "Code," the final, temporary and proposed U.S. Treasury Regulations promulgated thereunder and administrative and judicial interpretations thereof, all of which are subject to change, possibly with retroactive effect. For purposes of this summary, a "U.S. holder" will be deemed to refer only to any of the following holders of our ordinary shares:

- an individual who is either a U.S. citizen or a resident of the U.S. for U.S. federal income tax purposes;
- a corporation (or an entity taxable as a corporation) created or organized under the laws of the U.S. or any political subdivision thereof;
- an estate, the income of which is subject to U.S. federal income tax regardless of the source of its income; and
- a trust, if either (a) a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all the substantial decisions of the trust, or (b) the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

This summary does not consider all aspects of U.S. federal income taxation that may be relevant to particular U.S. holders by reason of their particular circumstances, including potential application of the alternative minimum tax, or any aspect of state, local or non-U.S. federal tax laws. In addition, this summary is directed only to U.S. holders that hold our ordinary shares as capital assets and does not address the considerations that may be applicable to particular classes of U.S. holders, including financial institutions, insurance companies, broker-dealers, tax-exempt organizations, holders whose functional currency is not the U.S. dollar, holders of our ordinary shares as part of a "straddle," "hedge" or "conversion transaction," holders, directly, indirectly or through attribution, of 10% or more of our outstanding ordinary shares and persons who own our ordinary shares through a partnership or other pass-through entity.

Each U.S. holder should consult with its own tax advisor as to the particular tax consequences to it of the purchase, ownership and sale of our ordinary shares, including the effects of applicable state, local, foreign or other tax laws and possible changes in the tax laws.

Distributions With Respect to Our Ordinary Shares

The amount of a distribution with respect to our ordinary shares will equal the amount of cash and the fair market value of any property distributed and will also include the amount of any Israeli taxes withheld, as described below under “Israeli Tax Considerations – Tax on Dividends.” Other than distributions in liquidation and distributions in redemption of stock that are treated as exchanges, a distribution paid by us with respect to our ordinary shares to a U.S. holder generally will be treated as a dividend to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of any distribution that exceeds these earnings and profits will be treated first as a non-taxable return of capital, reducing the U.S. holder’s tax basis in its ordinary shares, and then generally as capital gain. Currently, an individual U.S. holder’s “qualified dividend income” is subject to tax at a reduced rate of 15%. For this purpose, “qualified dividend income” generally includes dividends paid by a foreign corporation if either (a) the stock of such corporation with respect to which the dividends are paid is readily tradable on an established securities market in the U.S., including the Nasdaq National Market, or (b) such corporation is eligible for the benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The U.S. Secretary of the Treasury has indicated that the income tax treaty between the U.S. and Israel is satisfactory for this purpose. Dividends paid by a foreign corporation will not qualify for the 15% U.S. federal income tax rate, however, if such corporation is treated, for the tax year in which the dividends are paid or the preceding tax year, as a “foreign investment company,” a “foreign personal holding company” or a “passive foreign investment company” for U.S. federal income tax purposes. Based on the nature of our operations and the ownership of our ordinary shares, we do not believe that we would be treated as either a “foreign investment company” or a “foreign personal holding company,” and as discussed in more detail below under “Passive Foreign Investment Company Status,” we do not currently believe that we would be classified as a “passive foreign investment company” for U.S. federal income tax purposes. Accordingly, dividend distributions with respect to our ordinary shares should be treated as “qualified dividend income” and, subject to U.S. holders’ satisfaction of certain holding period requirements, should be eligible for the reduced 15% U.S. federal income tax rate. Corporate holders of our ordinary shares generally will not be allowed a deduction for dividends received on our ordinary shares.

A dividend paid by us in NIS will be included in the income of U.S. holders at the dollar amount of the dividend, based on the “spot rate” of exchange in effect on the date the distribution is includable in the U.S. holders’ income, regardless of whether the payment is in fact converted into dollars. The “spot rate” generally refers to a rate that reflects a fair market rate of exchange available to the public for currency under a “spot contract” in a free market and involving representative amounts. A “spot contract” is a contract to buy or sell a currency no more than two business days following the date of the execution of the contract. If a spot rate cannot be demonstrated, the U.S. Internal Revenue Service has the authority to determine the spot rate. U.S. holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that dollar value. Any subsequent gain or loss on NIS arising from exchange rate fluctuations during the period from the date a U.S. holder includes the dividend payment in income to the date such U.S. holder converts the payment to dollars will be taxable as ordinary income or loss and will be U.S.-source income or loss for U.S. foreign tax credit purposes.

Dividend income derived with respect to our ordinary shares will constitute “portfolio income” for purposes of the limitation on the use of passive activity losses and, therefore, generally may not be offset by passive activity losses, and generally will be treated as “investment income” for purposes of the limitation on the deduction of investment interest expense. Dividends paid by us generally will be foreign-source passive income for U.S. foreign tax credit purposes or, in the case of a U.S. holder that is a financial services entity, financial services income. Subject to certain limitations, U.S. holders may elect to claim a foreign tax credit against their U.S. federal income tax liability any Israeli income tax withheld from dividends received on our ordinary shares. U.S. holders that do not elect to claim a foreign tax credit may instead claim a deduction for Israeli income tax withheld. In addition, special rules may apply to the computation of foreign tax credits relating to qualified dividend income. The calculation of foreign tax credits and, in the case of a U.S. holder that elects to deduct foreign income taxes, the availability of deductions is complex and involves the application of rules that depend on a U.S. holder’s particular circumstances. U.S. holders are urged to consult their own tax advisors regarding the availability to them of foreign tax credits or deductions in respect of any Israeli tax withheld or paid.

Disposition of Our Ordinary Shares

Subject to the discussion below under “Passive Foreign Investment Company Status,” a U.S. holder’s sale or exchange of our ordinary shares generally will result in the recognition by such U.S. holder of capital gain or loss in an amount equal to the difference between the United States dollar value of the amount realized and the U.S. holder’s tax basis in the ordinary shares sold. This gain or loss will be long-term capital gain or loss if the ordinary shares sold have been held for more than one year at the time of the sale or exchange. If the U.S. holder’s holding period on the date of the sale or exchange is one year or less, such gain or loss will be a short-term capital gain or loss. Individual U.S. holders currently are subject to a maximum tax rate of 15% on long-term capital gains for tax years beginning on or before December 31, 2008. Short-term capital gains generally are taxed at the same rates applicable to ordinary income. See “Israeli Tax Considerations – Capital Gains Tax Applicable to Resident and Non-Resident Shareholders” for a discussion of taxation by Israel of capital gains realized on sales of capital assets. Any capital loss realized upon the sale, exchange or other disposition of our ordinary shares generally will be deductible only against capital gains and not against ordinary income, except that in the case of non-corporate U.S. holders, a capital loss is deductible in any year to the extent of capital gains plus ordinary income up to \$3,000. In general, any capital gain recognized by a U.S. holder upon the sale or exchange of our ordinary shares will be treated as U.S.-source income for U.S. foreign tax credit purposes. Under the tax treaty between the United States and Israel, gain derived from the sale, exchange or other disposition of ordinary shares by a holder who is a resident of the United States for purposes of the treaty and who sells the ordinary shares within Israel may be treated as foreign-source income for U.S. foreign tax credit purposes.

A U.S. holder's tax basis in its ordinary shares generally will be equal to the purchase price paid therefor by such U.S. holder. The holding period of each ordinary share owned by a U.S. holder will begin on the day following the date of the U.S. holder's purchase of such ordinary share and will include the day on which the ordinary share is sold by such U.S. holder.

In the case of a U.S. holder who uses the cash basis method of accounting and who receives NIS in connection with the sale or taxable disposition of ordinary shares, the amount realized will be based on the spot rate as determined on the settlement date of such exchange. If such U.S. holder subsequently converts NIS into dollars at a conversion rate other than the spot rate in effect on the settlement date, he, she or it may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss. A U.S. holder who uses the accrual method of accounting may elect the same treatment required of cash basis taxpayers with respect to a sale or taxable disposition of ordinary shares, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the U.S. Internal Revenue Service. If an accrual basis U.S. holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. holder may be deemed to have realized an immediate foreign currency gain or loss for U.S. federal income tax purposes because of differences between the dollar value of the NIS on the date of sale or other taxable disposition and on the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to gain or loss, if any, recognized by such U.S. holder on the sale or taxable disposition of ordinary shares.

Passive Foreign Investment Company Status

Generally, a foreign corporation is treated as a passive foreign investment company ("PFIC") for U.S. federal income tax purposes for any tax year if, in such tax year, either (i) 75% or more of its gross income, including its pro rata share of the gross income of any company in which it is considered to own 25% or more of the shares by value, is passive in nature (the "Income Test"), or (ii) the average percentage of its assets during such tax year, including its pro rata share of the assets of any company in which it is considered to own 25% or more of the shares by value, which produce, or are held for the production of, passive income (determined by averaging the percentage of the fair market value of its total assets which are passive assets as of the end of each quarter of such year) is 50% or more (the "Asset Test").

Based on the composition of our gross income and the composition and value of our gross assets during 2004, we do not believe that we were a PFIC in 2004, although it is possible that we would have been classified as a PFIC under the Asset Test in 2001, 2002 and 2003 principally because a significant portion of our assets continued to consist of the cash raised in connection with the two public offerings of our ordinary shares in 1999, and the public market value of our ordinary shares declined significantly during 2001, 2002 and the first half of 2003. The tests for determining whether we are a PFIC for any tax year are applied annually, and it is difficult to make accurate predictions regarding the composition of our future income and assets, the factors which are relevant to this determination. In addition, there is no definitive method prescribed in the Code, United States Treasury Regulations or administrative or judicial interpretations thereof for determining the value of a foreign corporation's assets for purposes of the Asset Test. While the legislative history of the United States Taxpayer Relief Act of 1997 indicates that "the total value of a publicly-traded foreign corporation's assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities," there remains substantial uncertainty regarding the valuation of a publicly-traded foreign corporation's assets for purposes of the Asset Test. Moreover, certain factors relevant to the PFIC determination, such as declines in the market value of our stock, are not within our control and can cause us to become a PFIC if, for example, we do not apply the net proceeds realized from our sale of notes in November 2004 to the acquisition of assets which generate active income. Accordingly, there can be no assurance that we will not be deemed a PFIC for 2004 or any future tax year.

In view of the uncertainty regarding our use of the net proceeds realized from our sale of notes in November 2004, the valuation of our assets for purposes of the Asset Test and the complexity of the issues regarding our treatment as a PFIC, U.S. holders are urged to consult their own tax advisors for guidance as to our status as a PFIC. For those U.S. holders who determine that we were a PFIC in 2004 or are a PFIC in any subsequent tax year and notify us in writing of their request for the information required in order to effectuate the QEF Election described below, we will promptly make such information available to them.

If we are treated as a PFIC for U.S. federal income tax purposes for any year during a U.S. holder's holding period of our ordinary shares and the U.S. holder does not make a QEF Election or a "mark-to-market" election (both as described below):

- "Excess distributions" by us to a U.S. holder would be taxed in a special way. "Excess distributions" with respect to any U.S. holder are amounts received by such U.S. holder with respect to our ordinary shares in any tax year that exceed 125% of the average distributions received by such U.S. holder from us during the shorter of (i) the three previous years, or (ii) such U.S. holder's holding period of our ordinary shares before the then-current tax year. Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares. A U.S. holder must include amounts allocated to the current tax year in its gross income as ordinary income for that year. A U.S. holder must pay tax on amounts allocated to each prior tax year in which we were a PFIC at the highest rate in effect for such prior year on ordinary income and the tax is subject to an interest charge at the rate applicable to deficiencies for income tax.
- The entire amount of any gain realized by a U.S. holder upon the sale or other disposition of our ordinary shares also would be treated as an excess distribution subject to tax as described above.

— The tax basis in ordinary shares acquired from a decedent who was a U.S. holder would not receive a step-up to fair market value as of the date of the decedent's death but would instead be equal to the decedent's basis, if lower.

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

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

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

A U.S. holder may make a QEF Election with respect to a PFIC for any tax year of the U.S. holder. A QEF Election is effective for the year in which the election is made and all subsequent tax years of the U.S. holder. Procedures exist for both retroactive elections and the filing of protective statements. An additional election is available to defer the payment of taxes that may result from a QEF Election, although interest must be paid on any deferred taxes. A U.S. holder making the QEF Election must make the election on or before the due date, as extended, for the filing of the U.S. holder's income tax return for the first tax year to which the election will apply. A U.S. holder must make a QEF Election by completing Form 8621 and attaching it to its U.S. federal income tax return, and must satisfy additional filing requirements each year the election remains in effect.

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

The implementation of many aspects of the Code's PFIC rules requires the issuance of regulations which in many instances have yet to be promulgated and which may have retroactive effect. We cannot be sure that any of these regulations will be promulgated or, if so, what form they will take or what effect they will have on the foregoing discussion. Accordingly, and due to the complexity of the PFIC rules, U.S. holders should consult their own tax advisors regarding our status as a PFIC and the eligibility, manner and advisability of making a QEF Election or a mark-to-market election.

Information Reporting And Backup Withholding

Any dividends paid on our ordinary shares to U.S. holders may be subject to U.S. federal tax information reporting requirements and the U.S. backup withholding tax (the backup withholding rate currently is 28%). In addition, the proceeds of a U.S. holder's sale of ordinary shares may be subject to tax information reporting and the U.S. backup withholding tax. Backup withholding will not apply if the U.S. holder (i) is a corporation or other exempt recipient, and demonstrates the fact when so required, or (ii) the U.S. holder provides a U.S. taxpayer identification number, certifies as to no loss of exemption from backup withholding and complies with any other applicable backup withholding requirements. Any amounts withheld under the U.S. backup withholding tax rules will be allowed as a refund or a credit against the U.S. holder's U.S. federal income tax liability, provided the required information is furnished to the U.S. Internal Revenue Service.

The foregoing discussion of certain U.S. federal income tax considerations is for general information only and is not tax advice. Accordingly, each U.S. holder should consult with his, her or its own tax adviser regarding U.S. federal, state, local and non-U.S. income and other tax consequences of the acquisition, ownership and disposition of ordinary shares.

F. DIVIDENDS AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

You may request a copy of our U.S. Securities and Exchange Commission filings, at no cost, by writing or calling us at AudioCodes Ltd., 1 Hayarden Street, Airport City, Lod, 701514, Israel, Attention: Itamar Rosen, General Counsel, telephone: 972-3-539-4000. A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices.

A copy of each document (or a translation thereof to the extent not in English) concerning AudioCodes that is referred to in this Annual Report on Form 20-F, is available for public view at our principal executive offices at AudioCodes Ltd., 1 Hayarden Street, Airport City, Lod, 701514, Israel.

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At December 31, 2004, we did not own any market risk sensitive instruments. We have contracted several long-term structured note deals that are sensitive to changes in interest rates. Due to the nature of our long-term investment, we do not believe that there is any material market risk exposure. Therefore, no quantitative tabular disclosures are required. However, we may in the future undertake hedging or other similar transactions or invest in market risk sensitive instruments if management determines that it is necessary to offset these risks. See “Item 3. Key Information—D. Risk Factors—Risks Relating to Operations in Israel.”

To protect against the changes in value of forecasted foreign currency cash flows resulting from salary payments, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted expenses denominated in foreign currencies with forward contracts.

During 2002, we entered into forward contracts to hedge a portion of the anticipated NIS payroll payments for periods of one to six months. These forward contracts are designated as cash flows hedges, as defined by SFAS No. 133, as amended, and are all highly effective as hedges of these expenses when the salary is recorded. The effective portion of the hedged instruments is included in payroll expenses in the statement of operations. During the year ended December 31, 2002, we recognized a net loss of \$18,000 related to the forward contracts hedging salary payments. At December 31, 2002, we expected to reclassify \$72,000 of net profit on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

During the year ended December 31, 2003, we recognized net income of \$426,000 related to the forward contracts hedging salary payments. At December 31, 2003, we expected to reclassify \$145,000 of net profit on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

During the year ended December 31, 2004, we recognized net income of \$87,000 related to the forward contracts hedging salary payments. At December 31, 2004, we expected to reclassify \$353,000 of net profit on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable

ITEM 15. CONTROLS AND PROCEDURES

As of the end of the period covered by this Annual Report, we performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). The evaluation was performed with the participation of our key corporate senior management and under the supervision of our Chairman of the Board, President and Chief Executive Officer, Shabtai Adlersberg, and our Chief Financial Officer, Nachum Falek. Our management, including Messrs. Adlersberg and Falek, concluded that our disclosure controls and procedures were effective in alerting them to material information, on a timely basis, required to be included in our periodic filings with the U.S. Securities and Exchange Commission. No change in our internal control over financial reporting has occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Joseph Tenne is an “audit committee financial expert” as defined in Item 16A of Form 20-F.

ITEM 16B. CODE OF ETHICS

In 2004, we adopted a Code of Conduct and Business Ethics that applies to our chief executive officer, chief financial officer and other senior financial officers. This Code has been posted on our website, www.audiocodes.com.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, has served as our independent public accountants for each of the years in the three-year period ended December 31, 2004. The following table presents the aggregate fees for professional audit services and other services rendered by Kost Forer Gabbay & Kasierer in 2003 and 2004.

	Year ended December 31, (Amounts in thousands)	
	2003	2004
Audit Fees	52.5	80
Audit Related Fees	7.6	230
Tax Fees	82.3	53
All Other Fees	-	-
Total	142.4	363

Audit Fees consist of fees billed for the annual audit of the company's consolidated financial statements and the statutory financial statements of the company. They also include fees billed for other audit services, which are those services that only the external auditor reasonably can provide, and include the provision of consents and the review of documents filed with the SEC.

Audit Related Fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the company's financial statements and include operational effectiveness of systems. They also include fees billed for other services in connection with merger and acquisition due diligence, as well as our offering of convertible notes and our filing of a registration statement on Form F-3 with respect to the convertible notes.

Tax Fees include fees billed for tax compliance services, including the preparation of tax returns and claims for refund; tax consultations, such as assistance and representation in connection with tax audits and appeals, transfer pricing, and requests for rulings or technical advice from taxing authorities; tax planning services; and expatriate tax compliance, consultation and planning services.

Audit Committee Pre-approval Policies and Procedures

The Audit Committee of AudioCodes' Board of Directors is responsible, among other matters, for the oversight of the external auditor subject to the requirements of Israeli law. The Audit Committee has adopted a policy regarding pre-approval of audit and permissible non-audit services provided by our independent auditors (the "Policy").

Under the Policy, proposed services either (i) may be pre-approved by the Audit Committee without consideration of specific case-by-case services as "general pre-approval"; or (ii) require the specific pre-approval of the Audit Committee as "specific pre-approval". The Audit Committee may delegate either type of pre-approval authority to one or more of its members. The appendices to the Policy set out the audit, audit-related, tax and other services that have received the general pre-approval of the Audit Committee, including those described in the footnotes to the table, above; these services are subject to annual review by the Audit Committee. All other audit, audit-related, tax and other services must receive a specific pre-approval from the Audit Committee.

The Audit Committee establishes budgeted fee levels annually for each of the four categories of audit and non-audit services that are pre-approved under the Policy, namely, audit, audit-related, tax and other services. Requests or applications to provide services that require specific approval by the Audit Committee are submitted to the Audit Committee by both the external auditor and the chief financial officer. At each regular meeting of the Audit Committee, the external auditor provides a report in order for the Audit Committee to review the services that the external auditor is providing, as well as the status and cost of those services.

During 2004, no services provided to AudioCodes by Kost Forer Gabbay & Kasierer were approved by the Audit Committee pursuant to the de minimis exception to the pre-approval requirement provided by paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

The following consolidated financial statements and related auditors' reports are filed as part of this Annual Report.

Report of Independent Auditors	F - 2
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Schedule II
SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS AT DECEMBER 31, 2004
(in thousands)

Description	Balance at Beginning of Period	Provision for doubtful accounts	Write-off of previously provided accounts	Ai-Logix acquisition	Balance at end of period
Year ended December 31, 2002:					
Allowance for doubtful accounts	1,233	71	(173)	-	1,131
Year ended December 31, 2003:					
Allowance for doubtful accounts	1,131	293	(975)	-	449
Year ended December 31, 2004:					
Allowance for doubtful accounts	449	187	(7)	56	685

Other schedules are omitted because they are not required or the required information is shown in the financial statements or notes thereto.

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

<u>Exhibit</u> <u>No.</u>	<u>Exhibit</u>
1.1	Memorandum of Association of Registrant.*†
1.2	Articles of Association of Registrant, as amended.**
2.1	Indenture, dated November 9, 2004, between AudioCodes Ltd. and U.S. Bank National Association, as Trustee, with respect to the 2.))% Senior Convertible Notes due 2024.****
4.1	AudioCodes Ltd. 1997 Key Employee Option Plan (C).*
4.2	AudioCodes Ltd. 1997 Key Employee Option Plan, Qualified Stock Option Plan--U.S. Employees (D).*
4.3	Founder's Agreement between Shabtai Adlersberg and Leon Bialik, dated January 1, 1993.*†
4.4	Share Purchase Agreement by and among AudioCodes Ltd., The Israel Private Equity Fund L.P., DS Polaris Ltd., Chase Capital Partners L.P. and Additional Investors, dated as of June 22, 1997.*
4.5	Investment Agreement between AudioCodes Ltd. and DSP Semiconductor, Inc., dated April 5, 1993.*
4.6	Investment Agreement between AudioCodes Ltd. and DSP Group, Inc., dated June 16, 1994.*
4.7	License Agreement between AudioCodes Ltd. and DSP Group, Inc., dated as of May 6, 1999.*†
4.8	Lease Agreement between AudioCodes Inc. and Spieker Properties, L.P., dated January 26, 2000.**
4.9	Agreement between AudioCodes Ltd. and DSP Group, Inc. dated as of May 6, 1999.*
4.10	OEM Purchase Agreement between AudioCodes Ltd. and Clarent Corporation, dated as of December 1, 1998.*

Exhibit
No.

Exhibit

- 4.11 Shareholders Agreement by and among DSP Group, Inc., Shabtai Adlersberg, Leon Bialik, Genesis Partners I, L.P., Genesis Partners I (Cayman) L.P., Polaris Fund II (Tax Exempt Investors) L.L.C., Polaris Fund II L.L.C., Polaris Fund II L.P., DS Polaris Trust Company (Foreign Residents) (1997) Ltd., DS Polaris Ltd., Dovrat, Shrem Trust Company (Foreign Funds) Ltd., Dovrat Shrem-Skies 92 Fund L.P. and Chase Equity Securities CEA, dated as of May 6, 1999.*
- 4.12 Agreement between AudioCodes Ltd. and DSP Group, Inc. and France Telecom and Universite de Sherbrooke, dated March 3, 1995.*
- 4.13 AudioCodes Ltd. 1997 Key Employee Option Plan (D).*
- 4.14 AudioCodes Ltd. 1997 Key Employee Option Plan (E).*
- 4.15 AudioCodes Ltd. 1999 Key Employee Option Plan (F), as amended.***
- 4.16 AudioCodes Ltd. 1997 Key Employee Option Plan, Qualified Stock Option Plan – U.S. Employees (E).*
- 4.17 AudioCodes Ltd. 1999 Key Employee Option Plan, Qualified Stock Option Plan – U.S. Employees (F).***
- 4.18 AudioCodes Ltd. 2001 Employee Stock Purchase Plan--Global Non U.S.§
- 4.19 AudioCodes Ltd. 2001 U.S. Employee Stock Purchase Plan.§
- 4.20 Lease Agreement between AudioCodes Ltd. And Gev-Yam Maman Nechasim BeLod Ltd., effective as of December 1, 2000.**†
- 4.21 Lease Agreement between AudioCodes Ltd. and Nortel Networks (Marketing and Sales) Israel Ltd., effective as of December 31, 2002.**††
- 4.22 Sublease Agreement between Ai-Logix, Inc. and Continental Resources, Inc., dated December 30, 2003.§§
- 4.23 Stock Purchase Agreement by and among AudioCodes Ltd., AudioCodes Inc., Ai-Logix, Inc. and AI Technologies N.V, dated as of May 12, 2004. §§.
- 4.24 OEM Purchase and Sale Agreement No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of April 28, 2003 *****§§
- 4.25 Amendment No. 1 to OEM Purchase and Sale No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of May 1, 2003 ***** §§.

Exhibit
No.

Exhibit

- 4.26 Purchase and Sale Agreement by and among Nortel Networks, Ltd., AudioCodes Inc. and AudioCodes Ltd., dated as of April 7, 2003. §§
- 4.27 Purchase Agreement, dated as of November 9, 2004, between AudioCodes Ltd. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Lehman Brothers Inc., as representatives of the initial purchasers of AudioCodes' 2.00% Senior Convertible Notes due 2024.****
- 4.28 Registration Rights Agreement, dated as of November 9, 2004, between AudioCodes Ltd. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Lehman Brothers Inc. and CIBC World Markets Corp.*****
- 4.29 Amendment No. 2 to OEM Purchase and Sale No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of January 1, 2005 §§§
- 4.30 Amendment No. 3 to OEM Purchase and Sale No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of February 15, 2005
- 4.31 Amendment No. 5 to OEM Purchase and Sale No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of January 1, 2005 §§§
- 4.32 Amendment No. 6 to OEM Purchase and Sale No. 011449 between AudioCodes Ltd and Nortel Networks Ltd., dated as of April 1, 2005
- 4.33 Lease Agreement between AudioCodes Inc. and CA-Gateway Office Limited Partnership, effective as of December , 2004.
- 8.1 Subsidiaries of the Registrant.
- 12.1 Certification of Shabtai Adlersberg, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 12.2 Certification of Nachum Falek, Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 13.1 Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 13.2 Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 14.1 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.

* Incorporated herein by reference to Registrant's Registration Statement on Form F-1 (File No. 333-10352) .

- † Hebrew original and English summary of Hebrew original.
- †† English summary of Hebrew original.
- ‡ Incorporated herein by reference to Registrant's Registration Statement on Form S-8 (File No. 333-13268) .
- § Incorporated herein by reference to Registrant's Registration Statement on Form S-8 (File No. 333-13378) .
- ** Incorporated herein by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2000.
- *** Incorporated herein by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2002.
- **** Incorporated by reference herein to Registrant's Registration Statement on Form F-3 (File No. 333-123859).
- ***** Confidential treatment has been granted for certain portions of the indicated document. The confidential portions have been omitted and filed separately with the Securities and Exchange Commission as required by Rule 24b-2 promulgated under the Securities Exchange Act of 1934.
- §§ Incorporated herein by reference to Registrant's Form 20-F for the fiscal year ended December 31, 2003.
- §§§ A request for confidentiality has been filed for certain portions of the indicated document. Confidential portions have been omitted and filed separately with the Securities and Exchange Commission as required by Rule 24b-2 promulgated under the Securities Exchange Act of 1934.

SIGNATURES

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

AUDIOCODES LTD.

BY: /S/ NACHUM FALEK

Nachum Falek
Vice President Finance and
Chief Financial Officer

Date: June 2, 2005

EXHIBIT INDEX

<u>Exhibit</u> <u>No.</u>	<u>Exhibit</u>
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14.1	Consent of Kost Forer and Gabbay & Kasierer, a member of Ernst & Young Global.

* A request for confidentiality has been filed for certain portions of the indicated document. Confidential portions have been omitted and filed separately with the Securities and Exchange Commission as required by Rule 24b-2 promulgated under the Securities Exchange Act of 1934.

AUDIOCODES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2004

IN U.S. DOLLARS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of

AUDIOCODES LTD.

We have audited the accompanying consolidated balance sheets of AudioCodes Ltd. ("the Company") and its subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at Item 2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2003 and 2004, and the related consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Tel-Aviv, Israel
January 24, 2005

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share and par value data

	December 31,	
	2003	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 48,898	\$ 166,832

Trade receivables (net of allowance for doubtful accounts of \$449 and \$685 as of December 31, 2003 and 2004, respectively)	7,717	14,470
Other receivables and prepaid expenses	2,972	4,608
Inventories	4,667	10,059
Total current assets	64,254	195,969
LONG-TERM INVESTMENTS:		
Long-term bank deposits and structured notes	50,270	50,195
Investment in an affiliated company	491	487
Severance pay funds	3,618	4,538
Total long-term investments	54,379	55,220
PROPERTY AND EQUIPMENT, NET	4,564	6,694
INTANGIBLE ASSETS AND DEFERRED CHARGES, NET	1,013	5,127
GOODWILL	4,320	9,135
Total assets	\$ 128,530	\$ 272,145
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 4,197	\$ 6,541
Other payables and accrued expenses	13,825	17,981
Total current liabilities	18,022	24,522
ACCRUED SEVERANCE PAY	3,990	4,978
SENIOR CONVERTIBLE NOTES	-	120,660
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital -		
Ordinary shares of NIS 0.01 par value:		
Authorized - 100,000,000 as of December 31, 2003 and 2004;		
Issued - 41,727,734 shares as of December 31, 2003 and 43,808,132 shares as of December 31, 2004; Outstanding - 37,785,595 shares as of December 31, 2003 and 39,865,993 shares as of December 31, 2004	121	126
Additional paid-in capital	116,518	126,700
Treasury stock	(11,320)	(11,320)
Deferred stock compensation	(174)	(108)
Accumulated other comprehensive income	145	353
Retained earnings	1,228	6,234
Total shareholders' equity	106,518	121,985
Total liabilities and shareholders' equity	\$ 128,530	\$ 272,145

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

Year ended December 31,

	2002	2003	2004
Revenues	\$ 27,189	\$ 44,228	\$ 82,756
Cost of revenues	13,006	20,037	34,375
Gross profit	14,183	24,191	48,381
Operating expenses:			
Research and development, net	13,022	15,476	20,009
Selling and marketing	14,288	14,537	19,891
General and administrative	3,353	4,066	4,851
Total operating expenses	30,663	34,079	44,751
Operating income (loss)	(16,480)	(9,888)	3,630
Financial income, net	2,623	1,883	2,165
Equity in losses of an affiliated company	300	429	516
Income (loss) before taxes on income	(14,157)	(8,434)	5,279
Taxes on income	-	-	273
Net income (loss)	\$ (14,157)	\$ (8,434)	\$ 5,006
Basic net earnings (loss) per share	\$ (0.37)	\$ (0.22)	\$ 0.13
Diluted net earnings (loss) per share	\$ (0.37)	\$ (0.22)	\$ 0.12

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury stock	Deferred stock compensation	Accumulated other comprehensive income	Retained earnings	Total comprehensive income (loss)	Total shareholders' equity
Balance as of January 1, 2002	\$ 120	\$ 113,878	\$ (6,401)	\$ (161)	\$ -	\$ 23,819		\$ 131,255
Purchase of treasury stock	-	-	(4,704)	-	-	-		(4,704)
Issuance of shares upon exercise of options, warrants and employee stock purchase plan	*) -	757	-	-	-	-		757
Amortization of deferred stock compensation	-	-	-	161	-	-		161
Comprehensive loss, net:								
Unrealized gain on forward contracts, net	-	-	-	-	72	-	\$ 72	72
Net loss	-	-	-	-	-	(14,157)	(14,157)	(14,157)
Total comprehensive loss, net							\$ (14,085)	
Balance as of December 31, 2002	120	114,635	(11,105)	-	72	9,662		113,384
Purchase of treasury stock	-	-	(215)	-	-	-		(215)
Issuance of shares upon exercise of options, warrants and employee stock purchase plan	1	1,659	-	-	-	-		1,660
Deferred stock compensation	-	224	-	(224)	-	-		-
Amortization of deferred stock compensation	-	-	-	50	-	-		50
Comprehensive loss, net:								
Unrealized gain on forward contracts, net	-	-	-	-	73	-	\$ 73	73
Net loss	-	-	-	-	-	(8,434)	(8,434)	(8,434)
Total comprehensive loss, net							\$ (8,361)	
Balance as of December 31, 2003	121	116,518	(11,320)	(174)	145	1,228		106,518

Issuance of shares upon exercise of options and employee stock purchase plan	5	10,182	-	-	-	-	10,187
Amortization of deferred stock compensation	-	-	-	66	-	-	66
Comprehensive income, net:							
Unrealized gain on forward contracts, net	-	-	-	-	208	-	208
Net income	-	-	-	-	-	5,006	5,006
Total comprehensive income, net						\$	5,214
Balance as of December 31, 2004	\$ 126	\$ 126,700	\$ (11,320)	\$ (108)	\$ 353	\$ 6,234	\$ 121,985

*) Represents an amount lower than \$1.

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2002	2003	2004
Cash flows from operating activities:			
Net income (loss)	\$ (14,157)	\$ (8,434)	\$ 5,006
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	2,073	3,040	2,979
Equity in losses of an affiliated company	300	429	516
Increase (decrease) in accrued severance pay, net	(89)	20	68
Amortization of deferred stock compensation	161	50	66
Amortization of senior convertible notes discount and deferred charges	-	-	28
Decrease (increase) in accrued interest on short-term and long-term bank deposits and structured notes	1,305	(270)	75
Increase in trade receivables, net	(1,006)	(3,274)	(4,907)
Increase in other receivables and prepaid expenses	(740)	(940)	(1,248)
Decrease (increase) in inventories	1,859	10	(3,712)
Increase in trade payables	768	1,795	1,329
Increase (decrease) in other payables and accrued expenses	(2,134)	1,145	3,155
Other	-	-	98
Net cash provided by (used in) operating activities	(11,660)	(6,429)	3,453
Cash flows from investing activities:			
Investment in an affiliated company	(149)	(621)	(512)
Purchase of property and equipment	(2,136)	(1,997)	(4,251)
Proceeds from sale of short-term bank deposits	15,605	63,074	-
Investment in long-term bank deposits and structured notes	-	(50,000)	(18,000)
Proceeds from structured notes called by the banks	-	-	18,000
Payment for acquisition of Universal Audio Server ("UAS") (1)	-	(4,373)	(2,500)
Payment for acquisition of Ai-Logix (2)	-	-	(8,684)
Net cash provided by (used in) investing activities	13,320	6,083	(15,947)
Cash flows from financing activities:			
Proceeds from issuance of senior convertible notes	-	-	125,000
Issuance costs for senior convertible notes	-	-	(394)
Initial Purchasers discount in respect of senior convertible notes	-	-	(4,365)
Proceeds from issuance of shares upon exercise of options, warrants and employee stock purchase plan	757	1,660	10,187
Purchase of treasury stock	(4,704)	(215)	-
Net cash provided by (used in) financing activities	(3,947)	1,445	130,428

Increase (decrease) in cash and cash equivalents	(2,287)	(1,099)	117,934
Cash and cash equivalents at the beginning of the year	50,086	47,799	48,898
Cash and cash equivalents at the end of the year	\$ 47,799	\$ 48,898	\$ 166,832
<u>Supplemental disclosure of cash flow activities:</u>			
Cash paid during the year for income taxes	\$ 207	\$ 120	\$ 91

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2002	2003	2004
<u>(1) Payment for acquisition of UAS</u>			
Net fair value of assets acquired of UAS at the date of acquisition (see also Note 1b):			
Property and equipment	\$ -	\$ 380	\$ -
Technology	-	1,173	-
Goodwill	-	4,320	1,000
Paid (unpaid) accrued liability	-	5,873	1,000
	-	(1,500)	1,500
	\$ -	\$ 4,373	\$ 2,500
<u>(2) Payment for acquisition of Ai-Logix</u>			
Net fair value of assets acquired and liabilities assumed of Ai-Logix at the date of acquisition (see also Note 1c):			
Working capital, net (excluding cash and cash equivalents)	\$ -	\$ -	\$ 1,440
Property and equipment	-	-	329
Technology	-	-	3,100
Goodwill	-	-	3,815
	\$ -	\$ -	\$ 8,684

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

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 1:- GENERAL

a. Business overview:

AudioCodes Ltd. ("the Company") and its wholly-owned subsidiaries: Ai Logix Inc., AudioCodes Inc., AudioCodes Europe and AudioCodes National Inc. (together "the Group") design, develop and market technologies and products for enabling the transmission of voice over packet media, gateway technologies and systems for converged networks. The Group's products are designed to enable the new voice infrastructure to original equipment manufacturers, network equipment providers, systems integrators and distributors in the telecommunications and networking industries.

b. Acquisition of the Universal Audio Server ("UAS") business from Nortel Networks Limited ("Nortel"):

On April 7, 2003, the Group purchased from Nortel selected assets of its Universal Audio Server business. As part of the transaction,

Nortel granted the Group a license to use its UAS technology and the Group has undertaken to act as an exclusive supplier to Nortel for its UAS products over a period of three years. In addition, the parties have entered into a development agreement in relation to future platforms.

The UAS product provides enhanced conferencing, multi-language announcement functionality, and other regulatory media server applications for voice over packet networks. The Group has undertaken to leverage the UAS product and technology in order to further enhance its media server products and increase related sales.

The consideration for the transaction amounted to \$5,500 in cash, of which: \$2,000 was paid at the closing date, \$2,000 was paid nine months after the closing date, and \$1,500 was paid twelve months after the closing date. Under the terms of the acquisition agreement (“the Agreement”), the Group was also required to pay \$1,000 as a contingent payment, upon Nortel completing product integration under the development agreement. In March 2004, product integration was completed and the \$1,000 contingent payment was paid and recorded as part of the acquisition cost as additional goodwill in accordance with the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combination”.

The acquisition was accounted for under the purchase method of accounting in accordance with SFAS No. 141. The results of UAS operations have been included in the consolidated financial statements since the acquisition date.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of the UAS business, were not material in relation to total consolidated revenues and net loss.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 1:- GENERAL (Cont.)

Based upon a valuation of tangible and intangible assets acquired, the Group has allocated the total acquisition cost of the UAS assets, as follows:

	<u>April 7, 2003</u>
Property and equipment	\$ 380
Technology (five years useful life)	1,173
Goodwill *)	5,320
	<u> </u>
Total assets acquired	<u>\$ 6,873</u>

*) Including \$1,000 of the total acquisition cost which was allocated to goodwill in March 2004.

Goodwill includes but is not limited to the synergistic value and potential competitive benefits that could be realized by the Company from the acquisition. Goodwill is not deductible for tax purposes. In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets”, goodwill arising from this acquisition will not be amortized (see also Note 2k).

The value assigned to tangible assets and intangible assets has been determined as follows:

Property and equipment are presented at current replacement cost.

The value assigned to technology amounted to \$1,173. The fair value of technology was determined using the Income Approach.

In accordance with the agreement, contingent payments in the maximum aggregate amount of \$12,500 was to be paid to Nortel based on net orders for UAS products placed by Nortel over the 18 month period following the closing date. These contingent payments were not considered part of the acquisition cost and as accrued were offset against related revenues earned by the Group from orders by Nortel for each respective period. The Group periodically assessed the expected earn out payments, based on net sales from orders placed by Nortel. In 2003, the Group accrued earn out payments in the amount of \$1,600, which were included in other payables and accrued expenses in the net amount. In 2004, the Group paid Nortel \$4,917 in cash in respect of actual sales for the relevant 18 month period. As of December 31, 2004, no further obligation for contingent payments to Nortel remains.

c. Acquisition of Ai-Logix Inc. (“Ai-Logix”):

On May 12, 2004, the Group acquired all of the outstanding Ordinary shares of Ai-Logix, a provider of advanced voice and data recording hardware integration cards for the call recording and voice or data logging industry. The Group has undertaken to apply Ai-Logix’s technology, strategic partnerships and customer base to expand its business into the call recording and computer telephony integration markets.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL (Cont.)

The Group paid \$ 10,000 in cash at the closing of the transaction. An additional payment is required to be made in April 2005 based on the achievement of revenue milestones and additional terms by the Ai-Logix business during 2004 and 2005. The contingent payment will be recorded as part of the acquisition cost as additional goodwill in accordance with the provisions of SFAS No. 141. This payment may be made, at the Group's option, in cash or by issuance of AudioCodes Ltd.'s Ordinary shares. In the event that the Group elects to make this payment by issuing Ordinary shares, it will be required to register such shares for sale under the U.S. Securities Act of 1933.

Ai-Logix became a wholly-owned subsidiary of AudioCodes Inc. and accordingly its results of operations have been included in the consolidated financial statements of the Group since the acquisition date.

This acquisition was accounted for under the purchase method of accounting in accordance with SFAS No. 141.

Based upon a valuation of tangible and intangible assets acquired, the Group has allocated the total acquisition cost of Ai-Logix's assets and liabilities, as follows:

	<u>May 12, 2004</u>
Trade receivables	\$ 1,846
Inventories	1,680
Prepaid expenses	180
Property and equipment	329
	<u>4,035</u>
Total tangible assets acquired	4,035
	<u>3,100</u>
Technology (five years useful life)	3,100
Goodwill	3,815
	<u>6,915</u>
Total intangible assets acquired	6,915
	<u>10,950</u>
Total tangible and intangible assets acquired	10,950
	<u>(1,015)</u>
Trade payables	(1,015)
Accrued expenses	(1,045)
Other current liabilities	(206)
	<u>(2,266)</u>
Total liabilities assumed	(2,266)
	<u>\$ 8,684</u>
Net assets acquired	\$ 8,684

Goodwill includes but is not limited to the synergistic value and potential competitive benefits that could be realized by the Company from the acquisition. Goodwill is not deductible for tax purposes. In accordance with SFAS No. 142, goodwill arising from this acquisition will not be amortized (see also Note 2k).

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 1:- GENERAL (Cont.)

The value assigned to tangible assets, intangible assets and liabilities has been determined as follows:

Current assets and liabilities are recorded at their carrying amounts. The carrying amounts of current assets and liabilities were reasonable proxies for their market value due to their short-term maturity. Property and equipment are presented at current replacement cost.

The value assigned to technology amounted to \$3,100. The fair value of technology was determined using the Income Approach.

The following unaudited pro forma information does not purport to represent what the Group's results of operations would have been had the acquisition of Ai-Logix been consummated on January 1, 2003 and 2004, respectively, nor does it purport to represent the results of operations of the Group for any future period.

Year ended December 31,

2003

2004

	Unaudited	
Revenues	\$ 57,532	\$ 88,125
Net income (loss)	\$ (8,045)	\$ 4,831
Basic net earnings (loss) per share	\$ (0.21)	\$ 0.13
Diluted net earnings (loss) per share	\$ (0.21)	\$ 0.11

- d. The Group is dependent upon sole source suppliers for certain key components used in its products, including certain digital signal processing chips. Although there is a limited number of manufacturers of these particular components, management believes that other suppliers could provide similar components at comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which could adversely affect the operating results of the Group and its financial position.
- e. As to a major customer data, see Note 15b.

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AUDICODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP").

- a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

- b. Financial statements in U.S. dollars:

A majority of the revenues of the Group is generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Group's costs is incurred in dollars. The Group's management believes that the dollar is the primary currency of the economic environment in which all the Group's entities operate. Thus, the functional and reporting currency of each of the Group's entities is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with SFAS No. 52, "Foreign Currency Translation". All transaction gains and losses of the remeasured 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 wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated upon consolidation.

- d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less, at the date acquired.

- e. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows:

Raw materials - using the "moving average cost" method. Finished products - on the basis of direct manufacturing costs.

The Group periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume and technological obsolescence. Based on these evaluations, inventory write-offs and write-down provisions are provided to cover risks arising from slow moving items, technological obsolescence, excess inventories, discontinued products and for market prices lower than cost.

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AUDICODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Long-term bank deposits and structured notes:

Bank deposits with maturities of more than one year are included in long-term investments and presented at their cost including accrued interest. As of December 31, 2004, the deposits are in U.S. dollars and bear interest at an average rate of 2.7%.

The Group accounts for investments in structured notes in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" and Emerging Issues Task Force ("EITF") No. 96-12, "Recognition of Interest Income and Balance Sheet Classification of Structured Notes". Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held-to-maturity when the Group has the intent and ability to hold these securities to maturity and are stated at amortized cost. As of December 31, 2003 and 2004, investments in structured notes approximate their market value.

g. Investment in an affiliated company:

The Company accounts for its investment in an affiliated company in which it has the ability to exercise significant influence over the operating and financial policies, using the equity method of accounting in accordance with the requirements of Accounting Principle Board ("APB") No. 18, "The Equity Method of Accounting for Investments in Common Stock".

Investment in affiliated company represents investments in Ordinary shares, Preferred shares and convertible loans. The Company applies EITF No. 99-10, "Percentage Used to Determine the Amount of Equity Method Losses". Accordingly, losses of the affiliated company are recognized based on the ownership level of the particular investee security held by the investor.

The Company's investment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable, in accordance with APB No. 18. As of December 31, 2004, based on management's most recent analyses, no impairment losses have been identified.

Due to an increase of the Company's ownership in the affiliated company during 2003, the investment which was previously accounted for using the cost method of accounting, was adjusted retroactively and accounted for under the equity method, resulting in the recording of equity losses totaling \$300 in 2002.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

h. Property and equipment:

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:

	%
Computers and peripheral equipment	33
Office furniture and equipment	6 - 20
Motor vehicles	15
Leasehold improvements	Over the term of the lease or the life of the asset, by the shorter of

i. Intangible assets and deferred charges:

Intangible assets acquired after July 1, 2001 are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. Accordingly, acquired technology is amortized over 5 years.

Cost incurred in respect of issuance of senior convertible notes are deferred and amortized by the effective interest rate method as a component of interest expenses, over the period from issuance to maturity, which is 20 years, in accordance with APB No. 21 "Interest on Receivables and Payables".

j. Impairment of long-lived assets:

The Group's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the undiscounted future 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. As of December 31, 2004, no impairment losses have been identified.

Under SFAS No. 144, a long-lived group of assets that is to be abandoned is considered disposed of when it ceases to be used. Thus, an entity that intends to abandon a group of long-lived assets in operations, should evaluate that group of assets as "held and used" and should determine whether it should revise its depreciation estimates to reflect a useful life that is shorter than initially expected and a salvage value consistent with the intention to abandon.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Effective October 1, 2003, as a result of the expected relocation of the Company's facilities in Israel, the Group changed the estimated useful life of certain leasehold improvements and other equipment to four months. The effect of the change in estimated useful life on the net loss and net loss per share for the year ended December 31, 2003 was \$(689) and \$(0.02). The annual expected effect of this change of estimated useful life for the following years is immaterial.

k. Goodwill:

Goodwill represents an excess of costs over the fair value of the net assets of businesses acquired under SFAS No. 142, "Goodwill and Other Intangible Assets".

SFAS No.142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment at the reporting unit level by comparing the fair value of the reporting unit with its carrying value. Fair value is determined using market capitalizations. The Company elected to perform its analysis, of goodwill impairment during the fourth quarter of 2004. The test was based on the Group's single operating segment and reporting unit structure. As of December 31, 2004, no impairment losses had been identified.

l. Revenue recognition:

The Group generates its revenues primarily from the sale of products. The Group sells its products through a direct sales force and sales representatives. The Group's products are generally a bundled hardware and software solution that is delivered together to its customers, which include original equipment manufacturers, network equipment providers, systems integrators and distributors in the telecommunications and networking industries, all of whom are considered end-users.

Revenues from products are recognized in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition in Financial Statements", when the following criteria are met: persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectibility is probable. The Group has no obligation to customers after the date in which products are delivered other than pursuant to warranty obligations and right of return.

The Group generally grants to its customers a right of return or the ability to exchange a specific percentage of total price paid for products they have purchased over a period of three months for other products. The Group maintains a provision for product returns and exchanges in accordance with SFAS No. 48, "Revenue Recognition When Right of Return Exists". The provision was deducted from revenues and amounted to \$272, \$294 and \$619 as of December 31, 2002, 2003 and 2004, respectively.

Revenues from the sale of products which were not yet determined to be final sales due to market acceptance or technological compatibility were deferred and included in deferred revenues.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Warranty costs:

The Group generally provides a warranty period of 12 months, at no extra charge. The Group estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized in accordance with FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" and SFAS No. 5 "Accounting for Contingencies". Factors that affect the Group's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Group periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. A tabular reconciliation of the changes in the Group's aggregate product warranty liability was not provided due to immateriality.

n. Research and development costs:

Research and development costs, net of grants received, are charged to the statement of operations as incurred.

Royalty-bearing grants from the Government of Israel for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred and included as a reduction of research and development costs. During 2002, 2003 and 2004, development grants recognized amounted to \$0, \$435 and \$765, respectively.

o. Income taxes:

The Group accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the

use of the liability method whereby account balances of deferred tax assets and liabilities 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 Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

p. Concentrations of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, long-term bank deposits and structured notes and trade receivables.

The majority of the Group's cash and cash equivalents, long-term bank deposits and structured notes are invested in U.S. dollar instruments with major banks in Israel and the United States. Such investments in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Group's investments are financially sound and, accordingly, minimal credit risk exists with respect to these financial investments.

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AUDICODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The trade receivables of the Group are derived from sales to customers located primarily in the United States, the Far East, Israel and Europe. The Group performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Group has determined to be doubtful of collection. The Group usually does not require collateral on trade receivables because most of its sales are to large and well-established companies.

q. Senior convertible notes:

The Company presents the outstanding principal amount of its senior convertible notes as a long-term liability, in accordance with APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants". The debt is classified as a long-term liability until the date of conversion on which it would be reclassified to equity, or at the first contractual redemption date, on which it would be reclassified as a short-term liability. Accrued interest on the senior convertible notes is included in "other payables and accrued expenses". The Initial Purchasers discount is recorded as a discount to the debt and amortized according to the interest method over the term of the senior convertible notes in accordance with EITF No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Industries", which is 20 years.

r. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings 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 SFAS No. 128, "Earnings Per Share".

In accordance with EITF No. 03-6 "Participating Securities and the Two-Class Method under FASB Statement No. 128", convertible notes that include a provision that reduces the conversion price based on the dividends declared by the issuer are not participating securities.

Senior convertible notes, outstanding stock options and warrants have been excluded from the calculation of the diluted net earnings (loss) per Ordinary share since such securities are anti-dilutive for all periods presented. The total weighted average number of shares related to the senior convertible notes, outstanding options and warrants excluded from the calculations of diluted net earnings (loss) per share was 6,869,166, 7,836,696 and 4,972,991 for the years ended December 31, 2002, 2003 and 2004, respectively.

s. Accounting for stock-based compensation:

The Group has elected to follow APB No. 25, "Accounting for Stock Issued to Employees" and FIN No. 44, "Accounting for Certain Transactions Involving Stock Compensation", in accounting for its employee stock option plans and its non-compensatory Employee Share Purchase Plan ("ESPP"). Under APB No. 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized.

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AUDICODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Group adopted the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", which amended certain provisions of SFAS No. 123 "Accounting for Stock-Based Compensation". The Group continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Group's net income (loss) and net earnings (loss) per share is required by SFAS No. 123 and has

been determined as if the Group had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value for these options was estimated at the date of grant using the Black and Scholes option pricing model and amortized over the vesting period. Fair values were estimated using the following weighted-average assumptions:

	2002	2003	2004
Dividend yield	0%	0%	0%
Expected volatility	113%	108%	87%
Risk-free interest	3%	3%	3%
Expected life	5 years	4 years	4 years

Black-Scholes pricing-model was used to estimate the fair value of the ESPP compensation. Assumptions are not provided due to immateriality.

Pro forma information under SFAS No. 123 is as follows:

	Year ended December 31,		
	2002	2003	2004
Net income (loss) as reported	\$ (14,157)	\$ (8,434)	\$ 5,006
Add: stock-based compensation expenses determined under the intrinsic value based method included in the reported net income (loss)	161	50	66
Deduct: stock-based compensation expenses determined under the fair value based method for all awards	(15,398)	(10,865)	(8,509)
Pro forma net loss	\$ (29,394)	\$ (19,249)	\$ (3,437)
Basic net earnings (loss) per share as reported	\$ (0.37)	\$ (0.22)	\$ 0.13
Diluted net earnings (loss) per share as reported	\$ (0.37)	\$ (0.22)	\$ 0.12
Pro forma basic net loss per share	\$ (0.76)	\$ (0.51)	\$ (0.09)
Pro forma diluted net loss per share	\$ (0.76)	\$ (0.51)	\$ (0.08)

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Group applies SFAS No. 123 and EITF No. 96-18 "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services", with respect to options and warrants issued to non-employees. SFAS No. 123 requires the use of option valuation models to measure the fair value of the options and warrants at the measurement date.

t. Severance pay:

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

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrender value of these policies and includes immaterial profits.

Severance expenses for the years ended December 31, 2002, 2003 and 2004, amounted to approximately \$878, \$1,127 and \$1,182, respectively.

u. Advertising expenses:

Advertising expenses are charged to the statements of operations as incurred. Advertising expenses for the years ended December 31,

2002, 2003 and 2004, amounted to \$154, \$211 and \$359, respectively.

v. Fair value of financial instruments:

The following methods and assumptions were used by the Group in estimating its fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate their fair value due to the short-term maturity of such instruments.

The carrying amounts of long-term bank deposits and structured notes are estimated by discounting the future cash flows using current interest rates for deposits of similar terms and maturities. The carrying amount of long-term deposits approximates their fair value.

The fair value of senior convertible notes is based on quoted market values and prevailing market rates, and approximates their carrying amount.

The fair value of foreign currency contracts (used for hedging purposes) is estimated by obtaining current quotes from investment bankers.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

w. Derivative instruments:

The Group uses derivatives instruments to manage exposures to foreign currency, related to salary payments denominated in New Israeli Shekel ("NIS"). The Group's objectives for holding derivatives are to minimize risks.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", requires a company to recognize all of its derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For those derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

At December 31, 2004, the Group expects to reclassify \$353 of net gains on derivative instruments from accumulated other comprehensive income to income during the next nine months.

Since the amounts of forward transactions do not exceed salary payments, those transactions are all highly effective and the results are recorded as payroll expenses, at the time that the hedged expense is recorded. When the Group hedges payrolls for following periods, then the results as of the balance sheet date are recorded in other comprehensive income.

x. Impact of recently issued accounting standards:

On December 16, 2004, the Financial Accounting Standards Board issued SFAS No. 123(R) (revised 2004), "Share-Based Payment", which is a revision of SFAS No. 123. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123 permitted, but not required, share-based payments to employees to be recognized based on their fair values while SFAS No. 123(R) requires all share-based payments to employees to be recognized based on their fair values. SFAS No. 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new standard will be effective for the Group in the first interim period beginning after June 15, 2005. The Company has not yet completed its analysis of the impact of adopting SFAS No. 123(R) and is therefore currently unable to quantify the effect on its financial statements. However, the adoption of this new statement may have a significant impact on the results of operations and net earnings per share of the Company as the Company will be required to expense the fair value of all share based payments.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". SFAS No. 151 amends Accounting Research Bulletin ("ARB") No. 43, "Restatement and Revision of Accounting Research Bulletins", Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges.

In addition, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Group does not expect that the adoption of SFAS No. 151 will have a material effect on its financial position or results of operations.

NOTE 3:- INVENTORIES

	December 31,	
	2003	2004
Raw materials	\$ 2,515	\$ 4,384
Finished products	2,152	5,675
	<u>\$ 4,667</u>	<u>\$ 10,059</u>

In the years ended December 31, 2002, 2003 and 2004, the Group wrote-off and wrote-down inventory in a total amount of \$1,684, \$835 and \$1,237, respectively. These amounts are included in cost of revenues.

NOTE 4:- LONG-TERM BANK DEPOSITS AND STRUCTURED NOTES

Long-term bank deposits and structured notes are composed as follows:

	December 31,			
	2003	2004	2003	2004
	Weighted average interest		U.S. dollars in thousands	
Long-term bank deposits (in U.S. dollars)	2.7%	2.7%	\$ 25,270	\$ 25,195
Structured notes (1)	4.4%	3.8%	25,000	25,000
			<u>\$ 50,270</u>	<u>\$ 50,195</u>

- (1) During 2003, the Group purchased callable structured notes at par value totaling \$25,000 for settlement during 2006 from several banks. During 2004, part of the structured notes purchased in 2003 at par amount of \$18,000, were called by the banks, and the Group purchased different structured notes at par value totaling \$18,000 for settlement during 2007. Under the arrangements with the banks, whether or not the structured notes bear interest depends upon the rate of the three months to one year LIBOR.

For each day in which the relevant LIBOR rate is below an agreed annual fixed rate, which ranges from 2% to 5% the structured notes bear interest at the rate of 3.08% to 4.5% per annum. On all other days, the structured notes do not bear any interest. As of December 31, 2004, investments in structured notes securities approximate their market value.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 5:- INVESTMENT IN AN AFFILIATED COMPANY

In December 2000, the Company signed an agreement to invest in an unrelated privately-held company ("affiliated company").

The Preferred shares owned in the affiliated company have a preference in liquidation and are convertible at the holder's option or upon an Initial Public Offering into Ordinary shares and on weighted average ratchet basis. During 2004, the Company invested an additional amount of \$512 in consideration for Series F Preferred shares, as part of an aggregate capital raising of \$1,200.

	December 31,	
	2003	2004
Net equity:		
Net equity as of purchase date	\$ 93	\$ 93
Unamortized goodwill	1,877	2,389
Accumulated net losses	(1,479)	(1,995)
Total investment	<u>\$ 491</u>	<u>\$ 487</u>

As of December 31, 2004, the Company holds 40% of the affiliated company's share capital.

NOTE 6:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2003	2004
Cost:		
Computers and peripheral equipment	\$ 8,276	\$ 10,492
Office furniture and equipment	3,314	5,244
Motor vehicles	111	48
Leasehold improvements	1,186	1,357
	12,887	17,141
Accumulated depreciation:		
Computers and peripheral equipment	5,934	8,004
Office furniture and equipment	1,476	2,127
Motor vehicles	104	48
Leasehold improvements	809	268
	8,323	10,447
Depreciated cost	\$ 4,564	\$ 6,694

Depreciation expenses amounted to \$2,073, \$2,880 and \$2,352 for the years ended December 31, 2002, 2003 and 2004, respectively.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 7:- INTANGIBLE ASSETS AND DEFERRED CHARGES

	December 31,	
	2003	2004
a. Cost:		
Acquired technology	\$ 1,173	\$ 4,273
Deferred charges	-	1,644
	1,173	5,917
Accumulated amortization:		
Acquired technology	160	787
Deferred charges	-	3
	160	790
Amortized cost	\$ 1,013	\$ 5,127

b. Amortization expenses related to acquired technology amounted to \$0, \$160 and \$627 for the years ended December 31, 2002, 2003 and 2004, respectively.

c. Expected amortization expenses related to acquired technology for the years ended December 31:

2005	\$ 860
2006	860
2007	860
2008	700
2009	206

\$ 3,486

d. Amortization expenses related to deferred charges amounted to \$3 for the year ended December 31, 2004.

NOTE 8:- OTHER PAYABLES AND ACCRUED EXPENSES

	December 31,	
	2003	2004
Employees and payroll accruals	\$ 4,040	\$ 6,355
Technology licensing fee provision	4,332	3,974
Government authorities	594	874
Accrued expenses	2,106	5,187
Deferred revenues	-	1,430
Third payment to Nortel with respect to acquisition	1,500	-
Accrual payment to Nortel, net	1,000	-
Others	253	161
	\$ 13,825	\$ 17,981

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- SENIOR CONVERTIBLE NOTES

In November 2004, the Company issued \$125,000 (including the exercise of the option as described below) aggregate principal amount of 2% Senior Convertible Notes due November 9, 2024 ("the Notes"). The Company is obligated to pay interest on the Notes semi-annually on May 9 and November 9 of each year commencing May 9, 2005.

The Notes are convertible, at the option of the holders at any time before the maturity date, into Ordinary shares of the Company at a conversion rate of 53.4474 Ordinary shares per one thousand dollars principal amount of Notes, representing a conversion price of approximately \$18.71 per share. The Notes are subject to redemption at any time on or after November 9, 2009, in whole or in part, at the option of the Company, at a redemption price of 100% of the principal amount plus accrued and unpaid interest. The Notes are subject to repurchase, at the holders' option, on November 9, 2009, November 9, 2014 or November 9, 2019, at a repurchase price equal to 100% of the principal amount plus accrued and unpaid interest, if any, on such repurchase date. The Company can choose to pay the repurchase price in cash, Ordinary shares or a combination of cash and Ordinary shares. As of December 31, 2004, the Notes are presented as a long-term liability.

The Notes were issued with a conversion price equal to \$18.71 per share, which reflected the closing share price on the Nasdaq on the date of the offering, which was \$14.12, plus a premium of 32.5%. In accordance with EITF No. 00-27, no beneficial conversion features was recognized nor recorded.

The additional amount that the Company can be required to pay in respect of the withholding taxes is accounted for as a contingency until resolved.

As part of the offering, the Company granted the Initial Purchasers an option to purchase at any time during 30 days from the date of the offering, up to an additional \$25,000 principal amount of senior convertible notes. The option, in accordance with SFAS No. 133, is not embedded and therefore should be measured on a stand-alone basis. On November 16, 2004, the option was exercised in full. Due to immateriality, the Company did not record this option and its exercise in the financial statements.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Group's facilities are rented under several lease agreements in Israel and the U.S. for periods ending in 2013.

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

2005	\$ 2,705
2006	2,591
2007	2,504
2008	2,371
2009	2,387
Thereafter	8,445
	\$ 21,003

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

Rent expenses for the years ended December 31, 2002, 2003 and 2004, were approximately \$1,713, \$1,829 and \$2,927, respectively.

- b. Royalty commitment to the Office of the Chief Scientist of Israel (“OCS”):

Under the research and development agreements of the Company with the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3%-4.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the OCS research and development grants received, linked to the U.S. dollars plus interest on the unpaid amount received based on the 12-month LIBOR rate applicable to dollar deposits. The Company is obligated to repay the Israeli Government for the grants received only to the extent that there are sales of the funded products.

The Company did not repay or accrue royalties for the year ended December 31, 2004, relating to such grants.

As of December 31, 2004, the Company had a contingent obligation to pay royalties in the amount of approximately \$1,200.

- c. Royalty commitments to a third party:

The Group entered into technology licensing fee agreements with third parties. Under the agreements, the Group agreed to pay the third parties royalty fees until 2008, based on 0.5%-2% of the Group’s total consolidated revenues.

From time to time, the Group may be subject to patent infringement claims that arise in the ordinary course of its business activities. The Group estimates and records liabilities for those contingent claims for which it believes future expenditures will be required and for which such expenditures can be reasonably estimated.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS’ EQUITY

- a. Treasury stock:

On January 10, 2001 and on April 28, 2002, the Company’s Board of Directors approved a share repurchase program pursuant to which the Company is authorized to purchase up to an aggregate amount of 4,000,000 of its outstanding Ordinary shares. As of December 31, 2004, the Company had purchased 3,942,139 of its outstanding Ordinary shares, at a weighted average price per share of \$2.87.

- b. Warrants issued to consultants:

During 1999, the Company issued warrants to consultants to purchase 4,000 and 50,000 Ordinary shares of NIS 0.01 par value at an exercise price of \$9.82 per share and \$18.82 per share, respectively, expiring seven years from the date of grant. Warrants to purchase 24,000 Ordinary shares at an exercise price of \$18.82 per share were exercisable immediately, and warrants to purchase 30,000 Ordinary shares are exercisable in four equal annual installments from the date of grant. During 2001, warrants to purchase 10,000 Ordinary shares at an exercise price of \$18.82 were exercised.

As of December 31, 2004, 44,000 warrants are outstanding and exercisable at a weighted average exercise price of \$18.

- c. Employee Stock Purchase Plan:

In May 2001, the Company’s Board of Directors adopted the Employee Stock Purchase Plan (“the Purchase Plan”), which provides for the issuance of a maximum of 2,000,000 Ordinary shares. As of December 31, 2004, 1,291,036 shares are still available for future issuance. Eligible employees can have up to 15% of their wages, up to certain maximums, to be used to purchase Ordinary shares. The Purchase Plan is implemented with purchases every six months occurring on January 31 and July 31 of each year. The price of the Ordinary shares purchased under the Purchase Plan is equal to 85% of the lower of the fair market value of the Ordinary shares on the commencement date of each offering period or on the semi-annual purchase date.

During the years ended December 31, 2002, 2003 and 2004, 226,799, 290,605 and 208,952 shares, respectively, were issued under the Purchase Plan for aggregate consideration of \$607, \$537 and \$1,332, respectively.

- d. Employee Stock Option Plans:

Under the Company’s 1997 and 1999 Stock Option Plans (“the Plans”), options to purchase Ordinary shares may be granted to officers, directors, employees and consultants of the Group.

The total number of shares authorized for grant of options under the Plans is 13,850,377. As of December 31, 2004, 1,188,500 shares are still available for future option grants.

Stock options granted under the Plans are exercisable usually at the fair market value of the Ordinary shares at the date of grant and expire ten or seven years from the date of grant. The options generally vest over four or five years, from the date of grant. Any options,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Group's stock option activity and related information for the years ended December 31, 2002, 2003 and 2004, is as follows:

	Year ended December 31,					
	2002		2003		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at the beginning of the year	7,042,392	\$ 9.50	7,202,088	\$ 8.21	8,425,947	\$ 7.76
Granted	1,376,289	\$ 2.69	1,737,500	\$ 3.94	1,693,000	\$ 11.96
Exercised	(195,000)	\$ 0.76	(269,742)	\$ 4.14	(1,869,446)	\$ 4.72
Forfeited	(1,021,593)	\$ 11.07	(243,899)	\$ 5.92	(396,701)	\$ 6.28
Outstanding at the end of the year	7,202,088	\$ 8.21	8,425,947	\$ 7.76	7,852,800	\$ 9.46
Options exercisable at the end of the year	3,181,218	\$ 9.27	4,526,834	\$ 9.39	4,094,213	\$ 10.98

The options outstanding as of December 31, 2004, have been separated into ranges of exercise prices, as follows:

Range of exercise price	Options outstanding as of December 31, 2004	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2004	Weighted average exercise price of exercisable options
\$			\$		\$
0-0.61	161,400	3.01	0.61	161,400	0.61
1.1	199,600	3.06	1.10	199,600	1.10
1.73-2.51	974,823	4.60	2.26	427,073	2.19
2.67-4	646,322	4.40	3.16	263,611	3.01
4.1-6.04	1,355,722	4.43	4.46	656,617	4.32
6.51-9.24	1,380,283	3.60	7.62	929,512	7.47
9.32-14	2,118,750	6.19	11.41	496,500	10.03
18.82-20.38	152,500	4.73	17.80	96,500	18.88
25.5-36.56	819,400	2.26	29.41	819,400	29.41
50.50	44,000	1.43	50.50	44,000	50.50
	7,852,800		9.46	4,094,213	10.98

The Company has recorded deferred stock compensation for options issued with an exercise price below the fair market value of the Ordinary shares on the date of grant. The deferred stock compensation has been amortized and recorded as compensation expense ratably over the vesting period of the options. Compensation expenses of approximately \$161, \$50 and \$66 were recognized during the years ended December 31, 2002, 2003 and 2004, respectively.

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

Options granted to employees in 2002, 2003 and 2004 have an exercise price equal to the fair market value of an Ordinary share at the grant date, except for options that were granted in 2003 to certain employees with an exercise price less than the share market price at the grant date. The weighted average fair values of the options granted during 2002, 2003 and 2004, were \$2.18, \$3.77 and \$7.63, respectively.

e. Dividends:

In the event that cash dividends are declared in the future, such dividends will be paid in NIS. The Company does not intend to pay cash dividends in the foreseeable future. (see also Note 12b.)

NOTE 12:- TAXES ON INCOME

a. Measurement of taxable income:

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 2002, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. Commencing in taxable year 2003, the Company has elected to measure its taxable income and file its tax return 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. Such an elective obligates the Company for three years. Accordingly, commencing taxable year 2003, results for tax purposes are measured in terms of earnings in dollars.

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

The Company's production facilities have been granted the status of an "Approved Enterprise" in accordance with the law under four separate investment programs. The programs were approved in February 1994, April 1996, September 1999, and March 2002. The Company is also a "Foreign Investors' Company", as defined by that law and, as such, is entitled to a ten-year period of benefit instead of a seven-year period and to an additional reduction in tax rates to 10% to 25% (based on the percentage of foreign ownership in each taxable year).

According to the provisions of the law, the Company has elected the "alternative benefits" - waiver of government grants in return for a tax exemption.

Income derived from the first "Approved Enterprise" program was tax-exempt for the two-year period ended December 31, 1999 and is eligible for a reduced tax rate of 10% to 25% for the eight year period ending December 31, 2007.

Income derived from the second "Approved Enterprise" program will be tax-exempt for a period of four years, and is subject to a corporate tax at the reduced rate of 10% to 25% for an additional period of six years. The benefit period will commence when the Company realizes taxable income from this enterprise.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

Income derived from the third and fourth "Approved Enterprise" programs will be tax-exempt for a period of two years, and is subject to a corporate tax at the reduced rate of 10% to 25% for an additional period of eight years. The benefit period will commence when the Company realizes taxable income from this enterprise.

The period of tax benefits detailed above is subject to limits of the earlier of 12 years from commencement of production or 14 years from receiving the certificate approval. Based on the aforementioned conditions, under the second, the third and the fourth expansion programs, the period of benefits for the production facilities, which has not yet commenced, will terminate in the years 2009, 2011 and 2014, respectively.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without imposing tax liability on the Company only upon the complete liquidation of the Company. As of December 31, 2004, retained earnings included approximately \$540 of tax-exempt income earned by the Company's "Approved Enterprise".

In the event of a distribution of such tax-exempt income as a cash dividend, in a manner other than upon the complete liquidation of the Company, it would be required to pay tax at the rate of 10% to 25% on the amount distributed and an income tax liability of approximately \$135 would be incurred as of December 31, 2004.

The Company's Board of Directors has determined that such tax-exempt income will not be distributed as dividends.

The law also grants entitlement to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published thereunder and the certificate of approval for the specific investments in "Approved Enterprises". 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. As of December 31, 2004, management believes that the Company is in compliance with all of the aforementioned conditions.

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular tax rate prevailing at that time.

c. Net operating losses carryforwards:

The Company has accumulated losses for tax purposes as of December 31, 2004, in the amount of approximately \$87 million, which may be carried forward and offset against taxable income in the future for an indefinite period.

Through December 31, 2004, Ai-Logix Inc. has a U.S. federal net operating loss carryforward of approximately \$8 million, which can be carried forward and offset against taxable income for 12 to 17 years, and expires from 2015 to 2022.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

Through December 31, 2004, AudioCodes Inc. has a U.S. federal net operating loss carryforward of approximately \$24 million, which can be carried forward and offset against taxable income for 15 to 20 years, and expires from 2015 to 2023.

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

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

The Company currently qualifies as an "Industrial Company" under the above law and as such is entitled to certain tax benefits, including accelerated depreciation and the deduction of public offering expenses in three equal annual payments.

e. Income (loss) before taxes consists of the following:

	Year ended December 31,		
	2002	2003	2004
Domestic	\$ (8,746)	\$ (7,338)	\$ 2,303
Foreign	(5,411)	(1,096)	2,976
	<u>\$ (14,157)</u>	<u>\$ (8,434)</u>	<u>\$ 5,279</u>

f. Income taxes are comprised as follows:

Current taxes	\$ -	\$ -	\$ 273
Foreign	\$ -	\$ -	\$ 273

g. 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 Group's deferred tax liabilities and assets are as follows:

	December 31,	
	2003	2004
Deferred tax assets:		
Reserves and allowances	\$ 2,495	\$ 6,748
Net operating loss carryforwards	37,548	44,048
Net deferred tax assets before valuation allowance	40,043	50,796
Valuation allowance	(40,043)	(50,796)
Net deferred tax assets	\$ -	\$ -

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

As of December 31, 2004, the Group has provided full valuation allowances in respect of deferred tax assets resulting from tax loss carryforwards and other temporary differences, due to its history of operating losses and current uncertainty concerning its ability to realize these deferred tax assets in the future. Management currently believes that since the Group has a history of losses for tax purposes it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the foreseeable future. During 2004, the Group increased its valuation allowance by approximately \$10,753.

AudioCodes Inc. has provided valuation allowances in respect of deferred tax assets resulting from tax benefits related to employee stock option exercises, which will be credited to additional paid-in capital when realized.

The main reconciling items between the statutory tax rate of the Group and the effective tax rate are carryforward tax losses, other deferred taxes for which a full valuation allowance was provided and the effects of "Approved Enterprise".

h. Tax rates:

In June 29, 2004, the Israeli Government passed the Amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004, which progressively reduces the tax rates applicable to companies from 36% to 35% in 2004 and to a rate of 30% in 2007. The amendment had no impact on the Group's financial statements.

i. Stamp tax:

Under Israel's Stamp Tax on Documents Law, certain documents are subject to stamp tax. Recently promulgated regulations provide for a gradual phase-out of the stamp tax by 2008. In 2004, however, the tax authorities began an enforcement campaign involving extensive audits of stamp tax obligation with respect to all agreements which had been signed since June 2003. In July and in August 2004, the Company received a demand from the Israeli Department of Customs and VAT to produce all agreements entered into by the Company for evaluation for payment of Israel stamp tax.

The Company has received legal advice that there are a variety of defenses relating to the obligation to pay stamp tax or to the amount to be paid. In addition, the Israeli Forum of Chief Financial Officers has filed a petition with the Israeli Supreme Court against enforcement of the law, and this petition is currently pending. If the Forum of CFOs' petition is rejected and the tax authorities do not accept the Company's defenses, the Company may be liable to pay stamp tax with respect to the period beginning June 1, 2003.

The Company's management believes that applicable provision in the financial statements as of December 31, 2004, are adequate to cover probable costs arising from imposition and enforcement of a stamp tax on the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 13:- BASIC AND DILUTED NET EARNINGS (LOSS) PER SHARE

	Year ended December 31,		
	2002	2003	2004
Numerator:			
Net income (loss) available to shareholders of Ordinary Shares	\$ (14,157)	\$ (8,434)	\$ 5,006
Numerator for diluted net earnings (loss) per share - income (loss) available to shareholders of Ordinary shares			
	\$ (14,157)	\$ (8,434)	\$ 5,006
Denominator:			
Denominator for basic earnings (loss) per share - weighted average number of Ordinary shares, net of treasury stock	38,518,000	37,509,000	38,613,597
Effect of dilutive securities:			
Employee stock options and ESPP	*) -	*) -	3,993,000

Senior convertible notes	-	-	*) -
Denominator for diluted net earnings (loss) per share - adjusted weighted average number of shares	38,518,000	37,509,000	42,606,597

*) Antidilutive.

NOTE 14:- FINANCIAL INCOME (EXPENSES), NET

	Year ended December 31,		
	2002	2003	2004
Financial expenses:			
Interest and others	\$ (139)	\$ (125)	\$ (487)
Financial income:			
Foreign currency translation differences	236	25	(90)
Interest and others	2,526	1,983	2,742
	2,762	2,008	2,652
	\$ 2,623	\$ 1,883	\$ 2,165

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

a. Summary information about geographic areas:

The Group manages its business on a basis of one reportable segment (see Note 1 for a brief description of the Group's business). The data is presented in accordance with SFAS No. 131 "Disclosure About Segments of an Enterprise and Related Information". Revenues in the table below are attributed to geographical areas based on the location of the end customers.

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AUDIOCODES LTD. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

The following presents total revenues for the years ended December 31, 2002, 2003 and 2004 and long-lived assets as of December 31, 2002, 2003 and 2004.

	2002		2003		2004	
	Total revenues	Long-lived assets	Total revenues	Long-lived assets	Total revenues	Long-lived assets
Israel	\$ 3,227	\$ 4,694	\$ 2,984	\$ 9,144	\$ 8,332	\$ 19,743
Americas	10,864	373	25,179	753	51,573	1,208
Europe	2,919	-	5,587	-	10,972	5
Far East	10,179	-	10,478	-	11,879	-
	\$ 27,189	\$ 5,067	\$ 44,228	\$ 9,897	\$ 82,756	\$ 20,956

b. Major customer's data as a percentage of total revenues:

	Year ended December 31,		
	2002	2003	2004
Customer A	1%	14%	19%

NOTE 16:- RELATED PARTIES

The following transactions and balances with DSP Group, Inc., are included in the financial statements as follows:

	<u>Year ended December 31,</u>		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
Revenues from royalty fees	\$ 209	\$ 261	\$ 47
Purchase of raw materials	\$ 19	\$ 15	\$ -

In October 1999, the Company entered into a development agreement with DSP Group Ltd., a company affiliated with DSP Group, Inc., and a third party. According to the agreement, DSP Group Ltd. will pay royalties for every chip actually sold by DSP Group Ltd. to third parties. During 2004, DSP Group, Inc. sold all its holdings in the Company.

AMENDMENT #2

TO

OEM PURCHASE AND SALE AGREEMENT NO. 011449 (“Agreement”)

BETWEEN SELLER CORPORATION AND NORTEL NETWORKS LIMITED

This Amendment #2 to OEM Purchase and Sale Agreement No. 011449 by and between Nortel Networks Limited, a Canada corporation with offices located at 8200 Dixie Road, Suite 100, Brampton, Ontario, Canada L6T 5P6 (Nortel Networks) and AudioCodes Ltd., an Israeli corporation with offices located at 1 Hayarden Street, Airport City Lod, 70151 (Seller), will be effective as of January 1, 2005.

WHEREAS, Nortel Networks and Seller entered into an OEM Purchase and Sale Agreement dated April 28, 2003, as amended (“Agreement”); and

WHEREAS, Nortel Networks and Seller wish to amend the Agreement for the purposes of Seller obligating itself to pay over a cash incentive to promote and sell AudioCodes’ Mediant 5000 Trunk Gateway Product (i.e., the Nortel Media Gateway 3500) (“Gateway 3500”);

NOW, THEREFORE, in consideration of the premises and the promises set forth herein, but only for purposes of promoting the sale by Nortel of Gateway 3500 Products to its customers, the parties agree as follows:

1. Nortel Networks and Seller agree to amend Section 9 of the Agreement by adding new Section 9.7, as follows:

“9.7 For each unit of AudioCodes’ Mediant 5000 Trunk Gateway Product (i.e., the Nortel Media Gateway 3500) (“Gateway 3500”) sold by Nortel Networks to a customer AudioCodes will pay to Nortel Networks a [*] (“Incentive Bonus”); provided, as follows:

- (a) Nortel Networks purchased the applicable unit of Gateway 3500 under the 45 day payment terms of Section 9.4 above and the return terms and conditions of Section 4 of this Agreement.
- (b) Only one Incentive Bonus will be due and payable by Seller for each Nortel Networks customer site at which at least one Gateway 3500 is installed.
- (c) The incentive Bonus will apply only to units of Gateway 3500 shipped by Seller to Nortel Networks (or drop shipped to Nortel Networks’ customer) from January 1, 2005 through June 30, 2005.

* Confidential

- 9.7.1 In addition to the preceding Seller will pay to Nortel Networks a [*] per Nortel Networks customer per Nortel Networks sales region (i.e., North America, Europe-Middle East, Africa, Caribbean and Latin America, or Asia Pacific) (“Regional Bonus”) at such time as units of Gateway 3500 sold by Nortel Networks have been installed in a region at two of a particular customer’s separate sites and have carried live traffic.
- 9.7.2 Seller agrees to pay each Incentive Bonus and Regional Bonus earned, as described above, within 45 days of receipt of written confirmation from Nortel Networks that the particular criteria for earning the applicable bonus has been met.
- 9.7.3 [*]

2. Except for Amendments 1 and 2, in all other respects the Agreement shall remain unchanged.

IN WITNESS WHEREOF, the parties have caused this Amendment No. 2 to the Agreement to be signed by their duly authorized representatives.

NORTEL NETWORKS LIMITED

AUDIOCODES LTD.

By: /s/ Nancy Scott

By: /s/ Ben Rabinowitz

Print Name: Nancy Scott
Title: SR Mgr. Supply Mgmt
Date: February 23, 2005

Print Name: Ben Rabinowitz
Title: VP Marketing and Sales, NA
Date: February 15, 2005

* Confidential

AMENDMENT #3

TO

OEM PURCHASE AND SALE AGREEMENT NO. 011449

BETWEEN SELLER CORPORATION AND NORTEL NETWORKS LIMITED

This Amendment #2 to OEM Purchase and Sale Agreement No. 011449 by and between Nortel Networks Limited, a Canada corporation with offices located at 8200 Dixie Road, Suite 100, Brampton, Ontario, Canada L6T 5P6 (Nortel Networks) and AudioCodes Ltd., an Israeli corporation with offices located at 1 Hayarden Street, Airport City Lod, 70151 (Seller), will be effective as of February 15, 2005.

WHEREAS, Nortel Networks and Seller entered into an OEM Purchase and Sale Agreement dated April 28, 2003, as amended (“Agreement”); and

WHEREAS, Nortel Networks and Seller wish to amend the Agreement for the purposes of adding an OEM Interface License to the Agreement to address interoperability issues with regard to certain Products described therein;

Now, therefore, the parties agree to amend the Agreement as follows:

- A. Add Exhibit N, “OEM Interface License” to the Agreement, attached to and incorporated in this Amendment 3 as Attachment.

Except for this Amendment No. 3, in all other respects the Agreement shall remain unchanged.

IN WITNESS WHEREOF, the parties have caused this Amendment No. 3 to the Agreement to be signed by their duly authorized representatives.

NORTEL NETWORKS LIMITED

AUDIOCODES LTD.

By: /s/ Nancy Scott

By: /s/ Ben Rabinowitz

Print Name: Nancy Scott
Title: SR Mgr. Supply Mgmt.
Date: February 3, 2005

Print Name: Ben Rabinowitz
Title: VP Marketing and Sales, NA
Date: February 15, 2005

EXHIBIT N

OEM INTERFACE LICENSE

1. DEFINITIONS. Capitalized terms that are defined in the Agreement (as defined below) shall have the meanings set forth in the Agreement, and the following capitalized terms, and other capitalized terms defined elsewhere in this Exhibit (“**Exhibit**”), will have the meanings set forth herein wherever used in this Exhibit:

- (a) “**Agreement**” means the parties’ OEM Purchase and Sale Agreement to which this Exhibit is attached, but solely to the extent such Agreement is applicable to Product(s) that are required to incorporate an Interface pursuant thereto.
- (b) “**Field of Use**” means use of an Interface solely in a Product **provided exclusively to Nortel Networks** solely for enabling such Product to interface with a System solely in accordance with the Technical Information and solely as and to the extent required pursuant to the Agreement.
- (c) “**Interface**” means an interface that incorporates and uses a Nortel Networks Interface to enable interoperation exclusively between a System and a Product solely in accordance with such Technical Information.
- (d) “**Interface Improvements**” means any innovations, improvements, enhancements, modifications and other derivatives of, and/or directed to, associated with and/or resulting from use of Technical Information and/or a Nortel Networks Interface, made or created by or for Seller, but, with respect to Technical Information, only to the extent primarily directed to and/or based on such Technical Information, or with respect to a Nortel Networks Interface, only to the extent related specifically to such Nortel Networks Interface.
- (e) “**Nortel Networks Interface**” means the System interface described in the Technical Information.
- (f) “**Seller Improvements**” means any innovations, improvements, enhancements, modifications and other derivatives to, and/or directed to, associated with and/or arising from Seller’s activities pursuant to and in accordance with the terms of this Agreement, excluding any Interface Improvements.
- (g) “**System**” means only the Nortel Networks products listed in Exhibit N-1 and future releases thereof during the Term.
- (h) “**Technical Information**” means the information contained in the specific versions of the document(s) listed in Exhibit N-1, including updates thereto and any other related technical information that may, at Nortel Networks sole discretion, be provided by Nortel Networks to Seller during the Term.

- (i) **“Technical Information IPR”** means the intellectual property rights owned by Nortel Networks specifically directed to and covering the Technical Information, and its use solely in accordance with and specifically limited by the terms of^(c) this Exhibit, solely to the extent of the Technical Information.

2. LICENSES

2.1 Grant of License. Subject to the terms and conditions of the Agreement, and during the Term, Nortel Networks, and/or Nortel Networks Limited and/or its Subsidiaries, to the extent of its legal right to do so, grants to Seller a personal, non-exclusive, non-transferable, non-sublicensable license under the Technical Information IPR:

- (a) to use (including copy) the Technical Information:
- (i) to develop and make interfaces solely for incorporation and use in Products solely within the Field of Use and solely to the extent necessary to perform Seller’s obligations pursuant to the Agreement;
 - (ii) to incorporate such Interfaces into Products in accordance with rights set forth in section 2.1(a)(i) and solely to the extent necessary to perform Seller’s obligations pursuant to the Agreement;
 - (iii) to support and maintain such Interfaces incorporated into Products in accordance with the Field of Use in accordance with rights set forth in section 2.1(a)(i) and solely to the extent necessary to perform Seller’s obligations pursuant to the Agreement; and
- (b) to use Interfaces incorporated in Products, solely to the extent of such Interfaces, solely within the Field of Use and to the extent necessary to perform Seller’s obligations pursuant to the Agreement.

2.2 Prohibited Uses. Technical Information shall not be used to reverse engineer any Nortel Networks Interface existing in or for any product, device or system of any kind, and shall not be used to implement an Interface in or with any product, device or system of any kind, including hardware and software, except for a Product solely within the Field of Use, or in or with any of Seller’s products outside the Field of Use. Seller shall not create or distribute any Interface in software that is subject to the GNU General Public License, or any similar “open source” license, that would grant third parties the right to receive the source code, or the object code of such Interface to the extent to which it incorporates the source code of such Interface, other than as permitted under this Agreement.

2.3 Grant Back License. Seller hereby agrees to grant to Nortel Networks an irrevocable, perpetual, non-exclusive, sublicensable, fully paid-up, royalty-free, worldwide license, under any and all of Seller’s intellectual property rights, to utilize, employ, practice and/or otherwise exploit any and all Seller Improvements. The preceding sentence does not obligate Seller to disclose or provide Seller improvements to Nortel Networks.

3. OWNERSHIP AND RESERVATION OF RIGHTS

3.1 Ownership. The Technical Information, including all copies thereof (including any and all portions thereof), and the Technical Information IPR are and shall continue to be owned exclusively by Nortel Networks. All Seller Improvements, and any intellectual property rights associated therewith, shall be owned exclusively by Seller. Notwithstanding the prior sentence, Nortel Networks shall exclusively own all Interface Improvements, and any intellectual property rights associated therewith to the extent such intellectual property rights are directed to and/or based on Technical Information and/or to the extent such intellectual property rights are related specifically to a Nortel Networks Interface. Seller shall disclose any such Interface Improvements to Nortel Networks in writing upon its conception and upon the reduction of such Interface Improvement to a detailed description, and shall take whatever reasonable steps may be necessary to assign the ownership of such Interface Improvements to Nortel Networks. Nortel Networks grants Seller a personal, non-exclusive, non-transferable, non-sublicensable right to use Interface Improvements in the course of Seller's exercise of, and solely to the extent of, the rights granted to Seller under Section 2.1 of this Agreement.

3.2 No Other Rights. Nortel Networks reserves all rights and licenses not expressly granted in this Agreement. Nothing in this Agreement shall be construed as implying or giving rise to any implied grant or license including any right to use a Product incorporating an Interface except to use such Interface incorporated therein solely in accordance with the Field of Use or any right to use an interface in combination with anything else except as expressly set forth in Section 2.1. Nothing contained in this Agreement shall be construed as conferring on (i) Nortel Networks an obligation to file, secure, protect, maintain and/or enforce any intellectual property right and/or (ii) Seller any right to bring any action on behalf of Nortel Networks and/or based on or related to the Technical Information or the Technical Information IPR. Furthermore, nothing contained in this Agreement shall limit Nortel Networks ability to use in any manner it chooses the Technical Information or the Technical Information IPR or further license the same to any other entity.

3.3 Third Party Technology/IPR. Seller acknowledges that no third party technical information and/or intellectual property rights are licensed to it pursuant to, or as a result of, this Exhibit. Seller shall be solely responsible for obtaining, including any fees and/or costs, any third party technical information and intellectual property rights it requires with respect to its activities pursuant to this Agreement and/or associated with Products incorporating Interfaces.

4. WARRANTIES; DISCLAIMER; LIMITATION OF LIABILITY

4.1 THE TECHNICAL INFORMATION, NORTEL NETWORKS INTERFACE(S) AND TECHNICAL INFORMATION IPR IS PROVIDED TO SELLER BY NORTEL NETWORKS (AND ITS SUPPLIERS/LICENSORS, IF ANY) "AS IS" WITHOUT WARRANTY OR CONDITION OF ANY KIND. NORTEL NETWORKS (AND ITS SUPPLIERS/LICENSORS, IF ANY) EXPRESSLY DISCLAIM ALL WARRANTIES AND CONDITIONS, STATUTORY, EXPRESS OR IMPLIED, INCLUDING, WITHOUT LIMITATION, ANY WARRANTY OR CONDITION OF TITLE, MERCHANTABILITY, FITNESS OR SUITABILITY FOR ANY PARTICULAR PURPOSE (EVEN IF ON NOTICE OF SUCH PURPOSE), NON-INFRINGEMENT, CUSTOM OR USAGE IN THE TRADE WITH RESPECT TO THE TECHNICAL INFORMATION, NORTEL NETWORKS INTERFACES AND TECHNICAL INFORMATION IPR, THE USE OR OTHER EXPLOITATION OF THE SAME AND/OR THE RESULTS OR ITEMS RESULTING FROM SUCH USE.

5. CONFIDENTIALITY OF TECHNICAL INFORMATION

5.1 Any Technical Information received by Seller pursuant to this Exhibit shall be used, disclosed, or copied, only for the purposes of, and only in accordance with, this Agreement. Seller shall use, as a minimum, the same degree of care as it uses to protect its own Technical Information of a similar nature, but no less than reasonable care, to prevent the unauthorized use, disclosure or publication of Technical Information. Without limiting the generality of the foregoing:

- (a) Seller shall only disclose Technical Information to its employees or any individual or entity which (i) has entered into a written agreement with Seller containing obligations of confidence substantially similar to (but no less protective of the Technical Information than) those contained in this Agreement and (ii) has a bona fide need to access the Technical Information consistent with the Seller's rights under this Agreement.
- (b) Seller shall not make or have made any copies of Technical Information except those copies which are necessary for the purposes of this Agreement; and
- (c) Seller shall affix to any copies it makes of the Technical Information, all proprietary notices or legends affixed to the Technical Information as they appear on the copies of the Technical Information originally received from Nortel Networks.

5.2 Exclusions. Seller shall not be bound by obligations restricting disclosure set forth in this Agreement with respect to any Technical Information which:

- (a) without obligation of confidentiality was rightfully known by Seller prior to disclosure, as evidenced by its business records;
- (b) was lawfully in the public domain prior to its disclosure, or lawfully becomes publicly available other than through a breach of this Agreement or any other confidentiality obligation on behalf of any third party;
- (c) was disclosed to Seller by a third party provided such third party, or any other party from whom such third party receives such information, is not in breach of any confidentiality obligation in respect of such information;
- (d) is independently developed by Seller, as evidenced by its business records; or
- (e) is disclosed when such disclosure is compelled pursuant to legal, judicial, or administrative proceedings, or otherwise required by law, but solely to the extent required thereby, provided that Seller advises Nortel Networks of any such disclosure in a timely manner prior to making any such disclosure, and provided that Seller shall apply for such legal protection as may be available with respect to the confidentiality of the Technical Information which is required to be disclosed.

6. GENERAL

6.1 Change of Control. “Change of Control” means any agreement, resolution or transaction to transfer or issue by sale, subscription, or any other disposition of any part or all of the corporate shares or assets of Seller, or of any parent or subsidiary corporation of Seller, or any corporation associated or affiliated with Seller (as those terms are defined by corporate legislation and any amendments thereto) so as to result in any change, from that existing as of the Effective Date, in effective control, directly or indirectly, of Seller. Change of Control of Seller or any business unit of Seller that has used or is using Technical Information, without the prior written consent of Nortel Networks, shall constitute an assignment of this Exhibit and therefore be governed by Section 6.3, Assignment, of this Exhibit.

6.2 Return of Technical Information. Seller shall, within thirty (30) days of termination or expiration of the Agreement, return to Nortel Networks or, if so requested by Nortel Networks, certify in writing to Nortel Networks that all copies of the Technical Information have been destroyed.

6.3 Assignment. Seller shall not assign, or otherwise transfer the Technical Information, or its rights under this Exhibit, nor delegate its duties or obligations under this Exhibit to any third party in whole or part, without the prior written consent of Nortel Networks. Any transfer by Seller of this Exhibit or any right or obligation hereunder by operation of law, reorganization, merger, amalgamation, Change of Control of Seller or any business unit of Seller relating to Products, or otherwise, without the prior written consent of Nortel Networks, shall constitute an assignment for the purposes of this section. Any purported assignment in violation of this provision shall be null and void and shall constitute a material breach of the Agreement that is not subject to cure.

[Remainder of this page intentionally left blank.]

1. Technical Information

[*] Specifications:
a) [*]

[*] Specifications:
a) [*]
b) [*]
c) [*]
d) [*]
e) [*]
f) [*]

2. System(s)

<u>Nortel Networks Products:</u>	<u>Release</u>	<u>Applicable Technical Information</u>
a) [*]	[*]	[*]
b) [*]	[*]	[*]
c) [*]	[*]	[*]
d) [*]	3.0	[*]

* Confidential

AMENDMENT #5

TO

OEM PURCHASE AND SALE AGREEMENT NO. 011449 (“Agreement”)

BETWEEN SELLER CORPORATION AND NORTEL NETWORKS LIMITED

This Amendment #5 to OEM Purchase and Sale Agreement No. 011449 by and between Nortel Networks Limited, a Canada corporation with offices located at 8200 Dixie Road, Suite 100, Brampton, Ontario, Canada L6T 5P6 (Nortel Networks) and AudioCodes Ltd., an Israeli corporation with offices located at 1 Hayarden Street, Airport City, 70100 Lod, Israel (Seller), will be effective as of January 1, 2005 (“Amendment #5 Effective Date”),

WHEREAS, Nortel Networks and Seller entered into an OEM Purchase and Sale Agreement dated April 28, 2003 (“Agreement”); and

WHEREAS, Nortel Networks and Seller wish to amend certain provisions relating to support of the Products in Exhibit C of the Agreement and for revising the terms and conditions of the Agreement;

NOW, THEREFORE, in consideration of the premises and the promises set forth herein, the parties agree as follows:

1. Nortel Networks and Seller agree to amend the following sections of Exhibit C of the Agreement as follows:

1.1 Delete the existing section 1.1 and replace by:

Remote Technical Services – At Nortel Networks’ request Seller will provide Nortel Networks with remote technical support services, as described in Section 3 of Exhibit H to this Agreement, under (a) Seller’s Standard Support Package (b) Seller’s Enhanced Support Package (c) Seller’s Standard Support Package with 24x7 support (“24x7 Support Package”), or (d) Seller’s Premium Support Package.

1.2 Delete the existing section 1.1.1 and replace by:

Support Package Charges – Seller’s basic charges for the support packages described in Section 1.1 will be calculated at the end of each calendar quarter during the Term. As of the last day of the calendar quarter, for each support package and each Product group (e.g., Mediant products) (and in the case of 24X7 and Premium Support Packages in each control protocol) supported under a package, Seller will calculate the total Price of all Products in the Product group (and, if applicable, each control protocol under each Product group) purchased by Nortel Networks since the Effective Date (“Product Group Cumulative Volume”).

- (a) *Standard and Enhanced* – For the Standard Support Program and the Enhanced Support Program Seller will apply the Product Group Cumulative Volume to the matrix in Subsection 1.1.2 below to determine the percentage to be used in calculating the technical support charges that will apply retroactively for the calendar quarter just ending. Seller will divide the resulting effective annual dollar charge by 4 to calculate the quarterly charge to invoice. For example, as of the end of the third quarter of the second year of the Term, if Nortel Networks’ Product Group Cumulative Volume for Mediant Product supported under the Standard Support Package were [*] and the Product Group Cumulative Volume for Mediant Products supported under the Enhanced Support Package were [*] million, then the applicable percentages to be used would be [*] and [*] respectively. Applying the percentages in the examples, the basic charges Seller would invoice Nortel Networks for the quarter would be [*] for the Standard Support Package and [*] for the Enhanced Support Package (i.e., the effective annual charge divided by [*]).
- (b) *24X7 and Premium Support Packages* – For the 24X7 and Premium Support Packages only, Nortel Networks agrees that the applicable support charges will be determined by applying the Product Group Cumulative Volume on a per control protocol basis (i.e., a separate calculation for each of [*], [*] and [*]). In that regard if the Product Group Cumulative Volume for one protocol for Mediant Products were [*] million then Seller would invoice Nortel Networks for [*] for the 24x7 Support Package for the calendar quarter just ending (i.e., the effective annual charge divided by 4), based on the “greater than” requirement in the applicable matrix column in Subsection 1.1.2.

1.3 Delete the existing section 1.1.2 and replace by:

Product Group Cumulative Volume per Support Package	[*]	[*]	[*]	[*]
Standard Support Program	[*]	[*]	[*]	[*]
Enhanced Support Program	[*]	[*]	[*]	[*]
Product Group Cumulative Volume (per Control Protocol) per Support Package	[*]	[*]	[*]	[*]
24x7 Support Package	[*]	[*]	[*]	[*]
Premium Support Package	[*]	[*]	[*]	[*]

* Confidential

1.4 Delete the existing section 1.1.3 and replace by:

Cumulative Total Support Program Charge – Notwithstanding Subsection 1.1.1 above, during the Term, if the total of all Product Group Cumulative Totals for the Standard or Enhanced or 24x7 Support Package exceeds [*], and until the total of all Product Group Cumulative Totals for the same support package equals [*], Nortel Networks will not be obligated to pay (i) more than [*] in support charges in each future calendar quarter for Standard Support Package; or, (ii) more than [*] in total support charges for all control protocols in each future calendar quarter for the 24X7 Support Package. Notwithstanding Subsection 1.1.1 above, during the Term, if the total of all Product Group Cumulative Totals for the Premium Support Package exceeds [*] million, and until the total of all Product Group Cumulative Totals for the same support package equals [*], Nortel Networks will not be obligated to pay more than [*] in total support charges for all control protocols in each future calendar quarter for the Premium Support Package. When the total of all Product Group Cumulative Totals for each of the Support Packages equals [*], the parties will agree on the applicable percentage to be used to calculate future support charges for the applicable support package.

2. Nortel Networks and Seller agree to amend the following sections of Exhibit H of the Agreement as follows:

2.1 Add new section 3.10A to read:

In addition to Seller's obligations under this Exhibit H for providing its Premium Support Package, the Premium Support Package will include Seller's providing Nortel Networks with Major Software Version releases that include performance enhancements as well as additional features.

2.2 Add new section to read:

— **Premium Support Payment Exclusions:**

- TP610 for Centrex IP (No upgrades)
- Lab equipment, PI equipment, R&R inventory
- Account specific "free labs" equipment that is used for initial lab testing potential Service Provider customers. "Free Labs" does not include equipment that will be later used in a network deployment.

3. This Amendment will serve as notice under the Agreement that Seller's address is now at 1 Hayarden Street, Airport City, Lod 70100, Israel.

4. Except for this Amendment No. 5, in all other respects the Agreement shall remain unchanged.

* Confidential

IN WITNESS WHEREOF, the parties have caused this Amendment No. 5 to the Agreement to be signed by their duly authorized representatives.

NORTEL NETWORKS LIMITED

AUDIOCODES LTD.

By: /s/ Nancy Scott

By: /s/ Ben Rabinowitz

Print Name: Nancy Scott
Title: SR Mgr. Supply Mgmt.
Date: May 6, 2005

Print Name: Ben Rabinowitz
Title: VP Marketing and Sales, NA
Date: April 27, 2005

AMENDMENT #6

TO

OEM PURCHASE AND SALE AGREEMENT NO. 011449 (“Agreement”)

BETWEEN AUDIOCODES LTD. AND NORTEL NETWORKS LIMITED

This Amendment #6 to OEM Purchase and Sale Agreement No. 011449 by and between Nortel Networks Limited, a Canada corporation with offices located at 8200 Dixie Road, Suite 100, Brampton, Ontario, Canada L6T 5P6 (Nortel) and AudioCodes Ltd., an Israeli corporation with offices located at 1 Hayarden Street, Airport City Lod, 70151 (Seller), will be effective as of April 1, 2005.

WHEREAS, Nortel and Seller entered into an OEM Purchase and Sale Agreement dated April 28, 2003, as amended (“Agreement”); and

WHEREAS, Nortel and Seller wish to amend the Agreement for the purposes of Seller’s obtaining the use of Nortel’s code-signing certificate and private key in relation to a Nortel customer’s use of the Mediant Products;

NOW, THEREFORE, in consideration of the premises and the promises set forth herein, the parties agree as follows:

1. Amend the Agreement by adding new Section 3.1 under Section 3 (Grant of Rights) as follows:

“3.1. Code Signing Certificate License – AudioCodes agrees to use Nortel Networks’ code-signing certificate and associated private key in all applicable Nortel Networks-specific Software loads, (i.e., MG3200EMS, MG3500EMS, MS2010 and MS2020). In that regard Nortel Networks hereby grants AudioCodes the right to use Nortel Networks’ code-signing certificate and associated private key on AudioCode’s Load Builder Server for the limited purpose of AudioCodes’ applying the code-signing certificate and private key (through AudioCodes’ jar files) to the described Nortel Networks-specific Software loads to support Nortel Networks’ customers launching Audiocodes applications. The preceding license is restricted to use with the described Software and must not be used for any other purpose, including, but not limited to, use on software loads that are provided to AudioCodes customers other than Nortel Networks.”

2. Except for Amendments 1 through 6, in all other respects the Agreement shall remain unchanged.

IN WITNESS WHEREOF, the parties have caused this Amendment No. 6 to the Agreement to be signed by their duly authorized representatives.

NORTEL NETWORKS LIMITED

AUDIOCODES LTD.

By: /s/ Nancy Scott

By: /s/ Ben Rabinowitz

Print Name: Nancy Scott
Title: SR Mgr. Supply Mgmt.
Date: May 6, 2005

Print Name: Ben Rabinowitz
Title: VP Marketing and Sales, NA
Date: April 27, 2005

GATEWAY OFFICE

**GATEWAY OFFICE IIC
2099 GATEWAY PLACE
SAN JOSE, CALIFORNIA**

OFFICE LEASE AGREEMENT

BETWEEN

**CA-GATEWAY OFFICE LIMITED PARTNERSHIP
("LANDLORD")**

AND

**AUDICODES, INC.
("TENANT")**

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OFFICE LEASE AGREEMENT

THIS OFFICE LEASE AGREEMENT (the “Lease”) is made and entered into as of December 29, 2004, by and between, **CA-GATEWAY OFFICE LIMITED PARTNERSHIP, a Delaware limited partnership (“Landlord”)** and **AUDIOCODES, INC., a Delaware corporation (“Tenant”)**. The following exhibits and attachments are incorporated into and made a part of the Lease: **Exhibit A** (Outline and Location of Premises), **Exhibit B** (Expenses and Taxes), **Exhibit C** (Work Letter), **Exhibit D** (Commencement Letter), **Exhibit E** (Building Rules and Regulations), **Exhibit F** (Additional Provisions), **Exhibit G** (Parking Agreement) and **Exhibit H** (Asbestos Notification), and **Exhibit I** (Form of Confidentiality Agreement).

1. Basic Lease Information.

- 1.01 “**Building**” shall mean the building located at 2099 Gateway Place, San Jose, California, commonly known as Gateway Office IIC, in the project commonly known as Gateway Office. “**Rentable Square Footage of the Building**” is deemed to be **116,043** square feet.
- 1.02 “**Premises**” shall mean the area shown on **Exhibit A** to this Lease. The Premises is located on the fifth floor and known as suite 500. If the Premises include one or more floors in their entirety, all corridors and restroom facilities located on such full floor(s) shall be considered part of the Premises. The “**Rentable Square Footage of the Premises**” is deemed to be 7,356 square feet. Landlord and Tenant stipulate and agree that the Rentable Square Footage of the Building and the Rentable Square Footage of the Premises are correct.
- 1.03 “**Base Rent**”:

Period	Annual Rate Per Square Foot	Monthly Base Rent
1 - 12	\$17.40	\$10,666.20
13 - 24	\$18.00	\$11,034.00
25 - 36	\$18.60	\$11,401.80
37 - 48	\$19.20	\$11,769.60
49 - 60	\$19.80	\$12,137.40

- 1.04 “**Tenant’s Pro Rata Share**”: 6.3390%.
- 1.05 “**Base Year**” for Taxes (defined in **Exhibit B**): 2005; “**Base Year**” for Expenses (defined in **Exhibit B**): 2005.
- 1.06 “**Term**”: A period of 60 months. Subject to Section 3, the Term shall commence on April 1, 2005 (the “**Commencement Date**”) and, unless terminated early in accordance with this Lease, end on March 31, 2010 (the “**Termination Date**”).
- 1.07 **Allowance(s)**: \$15,000.00, as more fully described in **Exhibit F** attached hereto.
- 1.08 “**Security Deposit**”: \$22,222.65, as more fully described in Section 6.
- 1.09 “**Guarantor(s)**”: As of the date of this Lease, there is no Guarantor.
- 1.10 “**Broker(s)**”: CB Richard Ellis, Inc.
- 1.11 “**Permitted Use**”: General office.

1.12 “Notice Address(es)”:

Landlord:
CA-Gateway Office Limited Partnership
c/o Equity Office
1740 Technology Drive, Suite 150
San Jose, California 95110
Attn: Gateway Office Property Manager

Tenant:
Prior to the Commencement Date:

2890 Zanker Road, Suite 200
San Jose, California 95134

From and after the Commencement Date:

At the Premises

A copy of any notices to Landlord shall be sent to Equity Office, One Market, 600 Spear Tower, San Francisco, CA 94105, Attn: Regional Counsel-San Jose.

1.13 “**Business Day(s)**” are Monday through Friday of each week, exclusive of New Year’s Day, Presidents Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day (“**Holidays**”). Landlord may designate additional Holidays that are commonly recognized by other office buildings in the area where the Building is located. “**Building Service Hours**” are 8:00 a.m. to 6:00 p.m. on Business Days.

1.14 “**Landlord Work**” means the work, if any, that Landlord is obligated to perform in the Premises pursuant to a separate agreement (the “**Work Letter**”), if any, attached to this Lease as **Exhibit C**.

1.15 “**Property**” means the Building and the parcel(s) of land on which it is located and, at Landlord’s discretion, the parking facilities and other improvements, if any, serving the Building and the parcel(s) of land on which they are located.

1.16 Intentionally omitted.

2. Lease Grant.

The Premises are hereby leased to Tenant from Landlord, together with the right to use any portions of the Property that are designated by Landlord for the common use of tenants and others (the “**Common Areas**”).

3. Adjustment of Commencement Date; Possession.

3.01 If Landlord is required to perform Landlord Work prior to the Commencement Date: (a) the date set forth in Section 1.06 as the Commencement Date shall instead be defined as the “**Target Commencement Date**”; (b) the actual Commencement Date shall be the date on which the Landlord Work is Substantially Complete (defined below); and (c) the Termination Date will be the last day of the Term as determined based upon the actual Commencement Date. Landlord’s failure to Substantially Complete the Landlord Work by the Target Commencement Date shall not be a default by Landlord or otherwise render Landlord liable for damages, provided, however, that if Landlord fails to Substantially Complete the Landlord Work and deliver the Premises to Tenant by the date which is sixty (60) days after the Target Commencement Date, then Tenant shall have the right to terminate this Lease upon thirty (30) days’ prior written notice to Landlord; further provided, however, that if Landlord Substantially Completes the Landlord’s Work within thirty (30) days after the date of the delivery of Tenant’s notice, Tenant’s notice shall be of no force and effect. Promptly after the determination of the Commencement Date, Landlord and Tenant shall enter into a commencement letter agreement in the form attached as **Exhibit D**. Tenant’s failure to execute and return the commencement letter, or to provide written objection to the statements contained in the letter, within 30 days after the date of the letter shall be deemed an approval by Tenant of the statements contained therein. If the Termination Date does not fall on the last day of a calendar month, Landlord and Tenant may elect to adjust the Termination Date to the last day of the calendar month in which the Termination Date occurs by the mutual execution of a commencement letter agreement setting forth such adjusted date. The Landlord Work shall be deemed to be “**Substantially Complete**” on the date that all Landlord Work has been performed, other than any minor details of construction, mechanical adjustment or any other similar matter, the non-completion of which does not materially interfere with Tenant’s use of the Premises. If Landlord is delayed in the performance of the Landlord Work as a result of the acts or omissions of Tenant, the Tenant Related Parties (defined in Section 13) or their respective contractors or vendors, including, without limitation, changes requested by Tenant to approved plans, Tenant’s failure to comply with any of its obligations under this Lease, or the specification of any materials or equipment with long lead times (a “**Tenant Delay**”), the Landlord Work shall be deemed to be Substantially Complete on the date that Landlord could reasonably have been expected to Substantially Complete the Landlord Work absent any Tenant Delay.

3.02 Subject to Landlord's obligation, if any, to perform Landlord Work, the Premises are accepted by Tenant in "as is" condition and configuration without any representations or warranties by Landlord. By taking possession of the Premises, Tenant agrees that the Premises are in good order and satisfactory condition. Notwithstanding the foregoing, Tenant's acceptance of the Premises shall be subject to Landlord's obligation to correct portions of the Landlord Work as set forth on a construction punch list prepared by Landlord and Tenant in accordance with the terms hereof. Within 15 days after the Substantial Completion of the Landlord Work, Landlord and Tenant shall together conduct an inspection of the Premises and prepare a "punch list" setting forth any portions of the Landlord Work that are not in conformity with the Landlord Work as required by the terms of this Lease. Notwithstanding the foregoing, at the request of Landlord, such construction punch list shall be mutually prepared by Landlord and Tenant prior to the date on which Tenant first begins to move its furniture, equipment or other personal property into the Premises. Landlord, as part of the Landlord Work, shall use good faith efforts to correct all such items within a reasonable time following the completion of the punch list. Landlord shall not be liable for a failure to deliver possession of the Premises or any other space due to the holdover or unlawful possession of such space by another party, however Landlord shall use reasonable efforts to obtain possession of the space. The commencement date for the space, in such event, shall be postponed until the date Landlord delivers possession of the Premises to Tenant free from occupancy by any party. If Tenant takes possession of the Premises before the Commencement Date, such possession shall be subject to the terms and conditions of this Lease and Tenant shall pay Rent (defined in Section 4.01) to Landlord for each day of possession before the Commencement Date. However, except for the cost of services requested by Tenant (e.g. freight elevator usage), Tenant shall not be required to pay Rent for any days of possession before the Commencement Date during which Tenant, with the approval of Landlord, is in possession of the Premises for the sole purpose of performing improvements or installing furniture, equipment or other personal property.

4. Rent.

4.01 Tenant shall pay Landlord, without any setoff or deduction, unless expressly set forth in this Lease, all Base Rent and Additional Rent due for the Term (collectively referred to as "**Rent**"). "**Additional Rent**" means all sums (exclusive of Base Rent) that Tenant is required to pay Landlord under this Lease. Tenant shall pay and be liable for all rental, sales and use taxes (but excluding income taxes), if any, imposed upon or measured by Rent. Base Rent and recurring monthly charges of Additional Rent shall be due and payable in advance on the first day of each calendar month without notice or demand, provided that the installment of Base Rent for the first full calendar month of the Term shall be payable upon the execution of this Lease by Tenant. All other items of Rent shall be due and payable by Tenant on or before 30 days after billing by Landlord. Rent shall be made payable to the entity, and sent to the address, Landlord designates and shall be made by good and sufficient check or by other means acceptable to Landlord. Tenant shall pay Landlord an administration fee equal to 5% of all past due Rent, provided that Tenant shall be entitled to a grace period of 5 days for the first 2 late payments of Rent in a calendar year. In addition, past due Rent shall accrue interest at 12% per annum. Landlord's acceptance of less than the correct amount of Rent shall be considered a payment on account of the earliest Rent due. Rent for any partial month during the Term shall be prorated. No endorsement or statement on a check or letter accompanying payment shall be considered an accord and satisfaction. Tenant's covenant to pay Rent is independent of every other covenant in this Lease.

4.02 Tenant shall pay Tenant's Pro Rata Share of Taxes and Expenses in accordance with **Exhibit B** of this Lease.

5. Compliance with Laws; Use.

The Premises shall be used for the Permitted Use and for no other use whatsoever. Tenant shall comply with all statutes, codes, ordinances, orders, rules and regulations of any municipal or governmental entity whether in effect now or later, including the Americans with Disabilities Act ("**Law(s)**"), regarding the operation of Tenant's business and the use, condition, configuration and occupancy of the Premises. In addition, Tenant shall, at its sole cost and expense, promptly comply with any Laws that relate to the "Base Building" (defined below), but only to the extent such obligations are triggered by Tenant's use of the Premises, other than for general office use, or Alterations or improvements in the Premises performed or requested by Tenant. "**Base Building**" shall include the structural portions of the Building, the public restrooms and the Building mechanical, electrical and plumbing systems and equipment located in the internal core of the Building on the floor or floors on which the Premises are located. Tenant shall promptly provide Landlord with copies of any notices it receives regarding an alleged violation of Law. Tenant shall comply with the rules and regulations of the Building attached as **Exhibit E** and such other reasonable rules and regulations adopted by Landlord from time to time, including rules and regulations for the performance of Alterations (defined in Section 9).

6. Security Deposit.

The Security Deposit shall be delivered to Landlord upon the execution of this Lease by Tenant and held by Landlord without liability for interest (unless required by Law) as security for the performance of Tenant's obligations. The Security Deposit is not an advance payment of Rent or a measure of damages. Landlord may use all or a portion of the Security Deposit to satisfy past due Rent or to cure any Default (defined in Section 18) by Tenant, or to satisfy any other loss or damage resulting from Tenant's Default as provided in Section 19. If Landlord uses any portion of the Security Deposit, Tenant shall, within 5 days after demand, restore the Security Deposit to its original amount. Landlord shall return any unapplied portion of the Security Deposit to Tenant within 45 days after the later to occur of: (a) determination of the final Rent due from Tenant; or (b) the later to occur of the Termination Date or the date Tenant surrenders the Premises to Landlord in compliance with Section 25. Landlord may assign the Security Deposit to a successor or transferee and, following the assignment, Landlord shall have no further liability for the return of the Security Deposit. Landlord shall not be required to keep the Security Deposit separate from its other accounts. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, or any similar or successor Laws now or hereinafter in effect.

7. Building Services.

7.01 Landlord shall furnish Tenant with the following services: (a) water for use in the Base Building lavatories; (b) customary heat and air conditioning in season during Building Service Hours, although Tenant shall have the right to receive HVAC service during hours other than Building Service Hours by paying Landlord's then standard charge for additional HVAC service and providing such prior notice as is reasonably specified by Landlord; (c) standard janitorial service on Business Days; (d) elevator service; (e) electricity in accordance with the terms and conditions in Section 7.02; (f) access to the Building for Tenant and its employees 24 hours per day/7 days per week, subject to the terms of this Lease and such protective services or monitoring systems, if any, as Landlord may reasonably impose, including, without limitation, sign-in procedures and/or presentation of identification cards; and (g) such other services as Landlord reasonably determines are necessary or appropriate for the Property.

7.02 Electricity used by Tenant in the Premises shall, at Landlord's option, be paid for by Tenant either: (a) through inclusion in Expenses (except as provided for excess usage); (b) by a separate charge payable by Tenant to Landlord; or (c) by separate charge billed by the applicable utility company and payable directly by Tenant. Without the consent of Landlord, Tenant's use of electrical service shall not exceed, either in voltage, rated capacity, use beyond Building Service Hours or overall load, that which Landlord reasonably deems to be standard for the Building. Landlord shall have the right to measure electrical usage by commonly accepted methods, including the installation of measuring devices such as submeters and check meters. If it is determined that Tenant is using excess electricity, Tenant shall pay Landlord Additional Rent for the cost of such excess electrical usage and for the cost of purchasing and installing the measuring device(s).

7.03 Landlord's failure to furnish, or any interruption, diminishment or termination of services due to the application of Laws, the failure of any equipment, the performance of repairs, improvements or alterations, utility interruptions or the occurrence of an event of Force Majeure (defined in Section 26.03) (collectively a "**Service Failure**") shall not render Landlord liable to Tenant, constitute a constructive eviction of Tenant, give rise to an abatement of Rent, nor relieve Tenant from the obligation to fulfill any covenant or agreement. However, if the Premises, or a material portion of the Premises, are made untenable for a period in excess of 3 consecutive Business Days as a result of a Service Failure that is reasonably within the control of Landlord to correct, then Tenant, as its sole remedy, shall be entitled to receive an abatement of Rent payable hereunder during the period beginning on the 4th consecutive Business Day of the Service Failure and ending on the day the service has been restored. If the entire Premises have not been rendered untenable by the Service Failure, the amount of abatement shall be equitably prorated.

8. Leasehold Improvements.

All improvements in and to the Premises, including any Alterations (defined in Section 9.03) (collectively, "**Leasehold Improvements**") shall remain upon the Premises at the end of the Term without compensation to Tenant, provided that Tenant, at its expense, in compliance with the National Electric Code or other applicable Law, shall remove any Cable (defined in Section 9.01 below). In addition, Landlord, by written notice to Tenant at least 60 days prior to the Termination Date, may require Tenant, at its expense, to remove any Landlord Work or Alterations that, in Landlord's reasonable judgment, are of a nature that would require removal and repair costs that are materially in excess of the removal and repair costs associated with standard office improvements (the Cable and such other items collectively are referred to as "**Required Removables**"). Required Removables shall include, without limitation, internal stairways, raised floors, personal baths and showers, vaults, rolling file systems and structural alterations and modifications. The Required Removables shall be removed by Tenant before the Termination Date. Tenant shall repair damage caused by the installation or removal of Required Removables. If Tenant fails to perform its obligations in a timely manner, Landlord may perform such work at Tenant's expense. Tenant, at the time it requests approval for a proposed Alteration, including any Initial Alterations or Landlord Work, as such terms may be defined in the Work Letter attached as **Exhibit C**, may request in writing that Landlord advise Tenant whether the Alteration, including any Initial Alterations or Landlord Work, or any portion thereof, is a Required Removable. Within 10 days after receipt of Tenant's request, Landlord shall advise Tenant in writing as to which portions of the alteration or other improvements are Required Removables.

9. Repairs and Alterations.

9.01 Tenant shall periodically inspect the Premises to identify any conditions that are dangerous or in need of maintenance or repair. Tenant shall promptly provide Landlord with notice of any such conditions. Tenant shall, at its sole cost and expense, perform all maintenance and repairs to the Premises that are not Landlord's express responsibility under this Lease, and keep the Premises in good condition and repair, reasonable wear and tear excepted. Tenant's repair and maintenance obligations include, without limitation, repairs to: (a) floor covering; (b) interior partitions; (c) doors; (d) the interior side of demising walls; (e) electronic, fiber, phone and data cabling and related equipment that is installed by or for the exclusive benefit of Tenant (collectively, "**Cable**"); (f) supplemental air conditioning units, kitchens, including hot water heaters, plumbing, and similar facilities exclusively serving Tenant; and (g) Alterations. Subject to the terms of Section 15 below, to the extent Landlord is not reimbursed by insurance proceeds, Tenant shall reimburse Landlord for the cost of repairing damage to the Building caused by the acts of Tenant, Tenant Related Parties and their respective contractors and vendors. If Tenant fails to make any repairs to the Premises for more than 30 days after notice from Landlord (although notice shall not be required in an emergency), Landlord may make the repairs, and Tenant shall pay the reasonable cost of the repairs, together with an administrative charge in an amount equal to 10% of the cost of the repairs. Notwithstanding anything to the contrary contained in the foregoing, if the nature of the repair is such that more than 30 days is reasonably required to perform said repair (except for emergency repairs) and the failure to immediately make such repair does not materially impact other tenants of the Building or the Building systems, then Landlord shall not have the right to make the repair on Tenant's behalf if Tenant commences the repair as soon as reasonably possible after receipt of notice from Landlord and diligently pursues said repair to completion, provided that Landlord shall have the right to complete any repair not completed as of the date that is 60 days after the initial receipt of notice of repair from Landlord.

9.02 Landlord shall keep and maintain in good repair and working order and perform maintenance upon the: (a) structural elements of the Building; (b) mechanical (including HVAC), electrical, plumbing and fire/life safety systems serving the Building in general; (c) Common Areas; (d) roof of the Building, including the roof membrane and structural elements; (e) exterior windows of the Building; and (f) elevators serving the Building. Landlord shall promptly make repairs for which Landlord is responsible. Landlord shall promptly make repairs for which Landlord is responsible. Tenant hereby waives any and all rights under and benefits of subsection 1 of Section 1932, and Sections 1941 and 1942 of the California Civil Code, or any similar or successor Laws now or hereinafter in effect.

9.03 Tenant shall not make alterations, repairs, additions or improvements or install any Cable (collectively referred to as "**Alterations**") without first obtaining the written consent of Landlord in each instance, which consent shall not be unreasonably withheld or delayed. However, Landlord's consent shall not be required for any Alteration that satisfies all of the following criteria (a "**Cosmetic Alteration**"): (a) is of a cosmetic nature such as painting, wallpapering, hanging pictures and installing carpeting; (b) is not visible from the exterior of the Premises or Building; (c) will not affect the Base Building; and (d) does not require work to be performed inside the walls or above the ceiling of the Premises. Cosmetic Alterations shall be subject to all the other provisions of this Section 9.03. Prior to starting work, Tenant shall furnish Landlord with plans and specifications (to the extent required by the nature of such Alteration); names of contractors reasonably acceptable to Landlord (provided that Landlord may designate specific contractors with respect to Base Building); required permits and approvals; evidence of contractor's and subcontractor's insurance in amounts reasonably required by Landlord and naming Landlord as an additional insured; and any security for performance in amounts reasonably required by Landlord. Changes to the plans and specifications must also be submitted to Landlord for its approval. Alterations shall be constructed in a good and workmanlike manner using materials of a quality reasonably approved by Landlord. Tenant shall reimburse Landlord for any sums paid by Landlord for third party examination of Tenant's plans for non-Cosmetic Alterations. In addition, Tenant shall pay Landlord a fee for Landlord's oversight and coordination of any non-Cosmetic Alterations equal to 5% of the cost of the non-Cosmetic Alterations. Upon completion, Tenant shall furnish "as-built" plans for non-Cosmetic Alterations, completion affidavits and full and final waivers of lien. Landlord's approval of an Alteration shall not be deemed a representation by Landlord that the Alteration complies with Law.

10. Entry by Landlord.

Landlord may enter the Premises to inspect or clean the Premises or to perform or facilitate the performance of repairs, alterations or additions to the Premises or any portion of the Building or, in the last 6 months of the Term (as may be renewed), to show the Premises to prospective Tenants. Except in emergencies or to provide Building services (in which event Landlord shall provide such notice as is reasonably practicable), Landlord shall provide Tenant with not less than 24 hours prior verbal notice of entry and shall use reasonable efforts to minimize any interference with Tenant's use of the Premises. If reasonably necessary, Landlord may temporarily close all or a portion of the Premises to perform repairs, alterations and additions. However, except in emergencies, Landlord will not close the Premises if the work can reasonably be completed on weekends and after Building Service Hours. If Landlord, in its reasonable judgment, must complete work during Building Service Hours, Landlord shall provide Tenant not less than 3 days prior verbal notice (except in the event of emergency). Entry by Landlord shall not constitute a constructive eviction or entitle Tenant to an abatement or reduction of Rent.

11. Assignment and Subletting.

11.01 Except in connection with a Permitted Transfer (defined in Section 11.04), Tenant shall not assign, sublease, transfer or encumber any interest in this Lease or allow any third party to use any portion of the Premises (collectively or individually, a "**Transfer**") without the prior written consent of Landlord, which consent shall not be unreasonably withheld, conditioned or delayed if Landlord does not exercise its recapture rights under Section 11.02. If the entity(ies) which directly or indirectly controls the voting shares/rights of Tenant changes at any time, such change of ownership or control shall constitute a Transfer unless Tenant is an entity whose outstanding stock is listed on a recognized securities exchange or if at least 80% of its voting stock is owned by another entity, the voting stock of which is so listed. Tenant hereby waives the provisions of Section 1995.310 of the California Civil Code, or any similar or successor Laws, now or hereinafter in effect, and all other remedies, including, without limitation, any right at law or equity to terminate this Lease, on its own behalf and, to the extent permitted under all applicable Laws, on behalf of the proposed transferee. Any Transfer in violation of this Section shall, at Landlord's option, be deemed a Default by Tenant as described in Section 18, and shall be voidable by Landlord. In no event shall any Transfer, including a Permitted Transfer, release or relieve Tenant from any obligation under this Lease.

11.02 Tenant shall provide Landlord with financial statements for the proposed transferee, a fully executed copy of the proposed assignment, sublease or other Transfer documentation and such other information as Landlord may reasonably request, subject to the execution by Landlord of a confidentiality agreement in substantially the form attached as **Exhibit I** hereto. Within 15 Business Days after receipt of the required information and documentation, Landlord shall either: (a) consent to the Transfer by execution of a consent agreement in a form reasonably designated by Landlord; (b) reasonably refuse to consent to the Transfer in writing, with the reasons therefor; or (c) in the event of an assignment of this Lease or subletting of more than 50% of the Rentable Square Footage of the Premises for more than 50% of the remaining Term (excluding unexercised options), recapture the portion of the Premises that Tenant is proposing to Transfer. If Landlord exercises its right to recapture, this Lease shall automatically be amended (or terminated if the entire Premises is being assigned or sublet) to delete the applicable portion of the Premises effective on the proposed effective date of the Transfer, although Landlord may require Tenant to execute a reasonable amendment or other document reflecting such reduction or termination. Tenant shall pay Landlord a review fee of \$1,500.00 for Landlord's review of any Permitted Transfer or requested Transfer.

11.03 Tenant shall pay Landlord 50% of all rent and other consideration which Tenant receives as a result of a Transfer that is in excess of the Rent payable to Landlord for the portion of the Premises and Term covered by the Transfer. Tenant shall pay Landlord for Landlord's share of the excess within 30 days after Tenant's receipt of the excess. Tenant may deduct from the excess, on a straight-line basis, all reasonable and customary expenses directly incurred by Tenant attributable to the Transfer. If Tenant is in Default, Landlord may require that all sublease payments be made directly to Landlord, in which case Tenant shall receive a credit against Rent in the amount of Tenant's share of payments received by Landlord.

11.04 Tenant may assign this Lease to a successor to Tenant by purchase (including, without limitation, the purchase of all or substantially all of Tenant's assets), merger, consolidation or reorganization (an "**Ownership Change**") or assign this Lease or sublet all or a portion of the Premises to an Affiliate without the consent of Landlord, provided that all of the following conditions are satisfied (a "**Permitted Transfer**"): (a) Tenant is not in Default; (b) in the event of an Ownership Change, Tenant's successor shall own substantially all of the assets of Tenant and have a net worth which is at least equal to Tenant's net worth as of the day prior to the proposed Ownership Change, or in the event of a Transfer to an Affiliate (defined below), Tenant continues to have a net worth equal to or greater than Tenant's net worth at the date of this Lease or the Affiliate has a net worth equal to Tenant's net worth at the date of this Lease; (c) the Permitted Use does not allow the Premises to be used for retail purposes; and (d) Tenant shall give Landlord written notice at least 15 Business Days prior to the effective date of the Permitted Transfer. Tenant's notice to Landlord shall include information and documentation evidencing the Permitted Transfer and showing that each of the above conditions has been satisfied. If requested by Landlord, Tenant's successor shall sign a commercially reasonable form of assumption agreement. "**Affiliate**" shall mean an entity controlled by, controlling or under common control with Tenant.

12. Liens.

Tenant shall not permit mechanics' or other liens to be placed upon the Property, Premises or Tenant's leasehold interest in connection with any work or service done or purportedly done by or for the benefit of Tenant or its transferees. Tenant shall give Landlord notice at least 15 days prior to the commencement of any work in the Premises to afford Landlord the opportunity, where applicable, to post and record notices of non-responsibility. Tenant, within 10 Business Days of notice from Landlord, shall fully discharge any lien by settlement, by bonding or by insuring over the lien in the manner prescribed by the applicable lien Law and, if Tenant fails to do so, Tenant shall be deemed in Default under this Lease and, in addition to any other remedies available to Landlord as a result of such Default by Tenant, Landlord, at its option, may bond, insure over or otherwise discharge the lien. Tenant shall reimburse Landlord for any amount paid by Landlord, including, without limitation, reasonable attorneys' fees.

13. Indemnity and Waiver of Claims.

Except to the extent caused by the negligence or willful misconduct of Landlord or any Landlord Related Parties (defined below), Tenant shall indemnify, defend and hold Landlord and Landlord Related Parties harmless against and from all liabilities, obligations, damages, penalties, claims, actions, costs, charges and expenses, including, without limitation, reasonable attorneys' fees and other professional fees (if and to the extent permitted by Law) (collectively referred to as "**Losses**"), which may be imposed upon, incurred by or asserted against Landlord or any of the Landlord Related Parties by any third party and arising out of or in connection with any damage or injury occurring in the Premises or any acts or omissions (including violations of Law) of Tenant, the Tenant Related Parties (defined below) or any of Tenant's transferees, contractors or licensees. Except to the extent caused by the negligence or willful misconduct of Tenant or any Tenant Related Parties, Landlord shall indemnify, defend and hold Tenant, its trustees, members, principals, beneficiaries, partners, officers, directors, employees and agents ("**Tenant Related Parties**") harmless against and from all Losses which may be imposed upon, incurred by or asserted against Tenant or any of the Tenant Related Parties by any third party and arising out of or in connection with the acts or omissions (including violations of Law) of Landlord or the Landlord Related Parties. Tenant hereby waives all claims against and releases Landlord and its trustees, members, principals, beneficiaries, partners, officers, directors, employees, Mortgagees (defined in Section 23) and agents (the "**Landlord Related Parties**") from all claims for any injury to or death of persons, damage to property or business loss in any manner related to (a) Force Majeure, (b) acts of third parties, (c) the bursting or leaking of any tank, water closet, drain or other pipe (except where due to the negligence of Landlord or any Landlord Related Party), (d) the inadequacy or failure of any security or protective services, personnel or equipment, or (e) any matter not within the reasonable control of Landlord.

14. Insurance.

Tenant shall maintain the following insurance ("**Tenant's Insurance**"): (a) Commercial General Liability Insurance applicable to the Premises and its appurtenances providing, on an occurrence basis, a minimum combined single limit of \$2,000,000.00; (b) Property/Business Interruption Insurance written on an All Risk or Special Cause of Loss Form, including earthquake sprinkler leakage, at replacement cost value and with a replacement cost endorsement covering all of Tenant's business and trade fixtures, equipment, movable partitions, furniture, merchandise and other personal property within the Premises ("**Tenant's Property**") and any Leasehold Improvements performed by or for the benefit of Tenant; (c) Workers' Compensation Insurance in amounts required by Law; and (d) Employers Liability Coverage of at least \$1,000,000.00 per occurrence. Any company writing Tenant's Insurance shall have an A.M. Best rating of not less than A-VIII. All Commercial General Liability Insurance policies shall name as additional insureds Landlord (or its successors and assignees), the managing agent for the Building (or any successor), EOP Operating Limited Partnership, Equity Office Properties Trust and their respective members, principals, beneficiaries, partners, officers, directors, employees, and agents, and other designees of Landlord and its successors as the interest of such designees shall appear. In addition, Landlord shall be named as a loss payee with respect to Property/Business Interruption Insurance on the Leasehold Improvements. All policies of Tenant's Insurance shall contain endorsements that the insurer(s) shall give Landlord and its designees at least 30 days' advance written notice of any cancellation, termination, material change or lapse of insurance. Tenant shall provide Landlord with a certificate of insurance evidencing Tenant's Insurance prior to the earlier to occur of the Commencement Date or the date Tenant is provided with possession of the Premises, and thereafter as necessary to assure that Landlord always has current certificates evidencing Tenant's Insurance. So long as the same is available at commercially reasonable rates, Landlord shall maintain so called All Risk property insurance on the Building at replacement cost value as reasonably estimated by Landlord, together with such other insurance coverage as Landlord, in its reasonable judgment, may elect to maintain.

15. Subrogation.

Landlord and Tenant hereby waive and shall cause their respective insurance carriers to waive any and all rights of recovery, claims, actions or causes of action against the other for any loss or damage with respect to Tenant's Property, Leasehold Improvements, the Building, the Premises, or any contents thereof, including rights, claims, actions and causes of action based on negligence, which loss or damage is (or would have been, had the insurance required by this Lease been carried) covered by insurance. For the purposes of this waiver, any deductible with respect to a party's insurance shall be deemed covered by and recoverable by such party under valid and collectable policies of insurance.

16. Casualty Damage.

16.01 If all or any portion of the Premises becomes untenable by fire or other casualty to the Premises (collectively a "**Casualty**"), Landlord, but in no event later than 45 days following the date of Casualty, shall cause a general contractor selected by Landlord to provide Landlord and Tenant with a written estimate of the amount of time required using standard working methods to Substantially Complete the repair and restoration of the Premises and any Common Areas necessary to provide access to the Premises ("**Completion Estimate**"). If the Completion Estimate indicates that the Premises or any Common Areas necessary to provide access to the Premises cannot be made tenable within 270 days from the date the repair is started, then either party shall have the right to terminate this Lease upon written notice to the other within 10 Business Days after receipt of the Completion Estimate. Tenant, however, shall not have the right to terminate this Lease if the Casualty was caused by the negligence or intentional misconduct of Tenant or any Tenant Related Parties. In addition, Landlord, by notice to Tenant within 90 days after the date of the Casualty, shall have the right to terminate this Lease if: (1) the Premises have been materially damaged and there is less than 2 years of the Term remaining on the date of the Casualty; (2) any Mortgagee requires that the insurance proceeds be applied to the payment of the mortgage debt; or (3) a material uninsured loss to the Building or Premises occurs. In addition to Landlord's right to terminate as provided herein, Tenant shall have the right to terminate this Lease if: (a) a substantial portion of the Premises has been damaged by Casualty and such damage cannot reasonably be repaired within 60 days after receipt of the Completion Estimate; (b) there is less than 1 year of the Term remaining on the date of such Casualty; (c) the Casualty was not caused by the negligence or willful misconduct of Tenant or its agents, employees or contractors; and (d) Tenant provides Landlord with written notice of its intent to terminate within 60 days after the date of the Casualty.

16.02 If this Lease is not terminated, Landlord shall promptly and diligently, subject to reasonable delays for insurance adjustment or other matters beyond Landlord's reasonable control, restore the Premises and Common Areas. Such restoration shall be to substantially the same condition that existed prior to the Casualty, except for modifications required by Law or any other modifications to the Common Areas deemed desirable by Landlord. Upon notice from Landlord, Tenant shall assign or endorse over to Landlord (or to any party designated by Landlord) all property insurance proceeds payable to Tenant under Tenant's Insurance with respect to any Leasehold Improvements performed by or for the benefit of Tenant; provided if the estimated cost to repair such Leasehold Improvements exceeds the amount of insurance proceeds received by Landlord from Tenant's insurance carrier, the excess cost of such repairs shall be paid by Tenant to Landlord prior to Landlord's commencement of repairs. Within 15 days of demand, Tenant shall also pay Landlord for any additional excess costs that are determined during the performance of the repairs to the Premises. In no event shall Landlord be required to spend more for the restoration of the Leasehold Improvements than the proceeds received by Landlord, whether insurance proceeds or proceeds from Tenant. Landlord shall not be liable for any inconvenience to Tenant, or injury to Tenant's business resulting in any way from the Casualty or the repair thereof. Provided that Tenant is not in Default, during any period of time that all or a material portion of the Premises is rendered untenable as a result of a Casualty, the Rent shall abate for the portion of the Premises that is untenable and not used by Tenant.

16.03 The provisions of this Lease, including this Section 16, constitute an express agreement between Landlord and Tenant with respect to any and all damage to, or destruction of, all or any part of the Premises or the Property, and any Laws, including, without limitation, Sections 1932(2) and 1933(4) of the California Civil Code, with respect to any rights or obligations concerning damage or destruction in the absence of an express agreement between the parties, and any similar or successor Laws now or hereinafter in effect, shall have no application to this Lease or any damage or destruction to all or any part of the Premises or the Property.

17. Condemnation.

Either party may terminate this Lease if any material part of the Premises is taken or condemned for any public or quasi-public use under Law, by eminent domain or private purchase in lieu thereof (a “**Taking**”). Landlord shall also have the right to terminate this Lease if there is a Taking of any portion of the Building or Property which would have a material adverse effect on Landlord’s ability to profitably operate the remainder of the Building. The terminating party shall provide written notice of termination to the other party within 45 days after it first receives notice of the Taking. The termination shall be effective as of the effective date of any order granting possession to, or vesting legal title in, the condemning authority. If this Lease is not terminated, Base Rent and Tenant’s Pro Rata Share shall be appropriately adjusted to account for any reduction in the square footage of the Building or Premises. All compensation awarded for a Taking shall be the property of Landlord. The right to receive compensation or proceeds are expressly waived by Tenant, however, Tenant may file a separate claim for Tenant’s Property and Tenant’s reasonable relocation expenses, provided the filing of the claim does not diminish the amount of Landlord’s award. If only a part of the Premises is subject to a Taking and this Lease is not terminated, Landlord, with reasonable diligence, will restore the remaining portion of the Premises as nearly as practicable to the condition immediately prior to the Taking. Tenant hereby waives any and all rights it might otherwise have pursuant to Section 1265.130 of the California Code of Civil Procedure, or any similar or successor Laws.

18. Events of Default.

In addition to any other default specifically described in this Lease, each of the following occurrences shall be a “**Default**”: (a) Tenant’s failure to pay any portion of Rent when due, if the failure continues for 3 days after written notice to Tenant (“**Monetary Default**”); (b) Tenant’s failure (other than a Monetary Default) to comply with any term, provision, condition or covenant of this Lease, if the failure is not cured within 20 days after written notice to Tenant provided, however, if Tenant’s failure to comply cannot reasonably be cured within 20 days, Tenant shall be allowed additional time (not to exceed 60 days) as is reasonably necessary to cure the failure so long as Tenant begins the cure within 20 days and diligently pursues the cure to completion; (c) Tenant permits a Transfer without Landlord’s required approval or otherwise in violation of Section 11 of this Lease; (d) Tenant or any Guarantor becomes insolvent, makes a transfer in fraud of creditors, makes an assignment for the benefit of creditors, admits in writing its inability to pay its debts when due or forfeits or loses its right to conduct business; (e) the leasehold estate is taken by process or operation of Law; (f) in the case of any ground floor or retail Tenant, Tenant does not take possession of or abandons or vacates all or any portion of the Premises; or (g) Tenant is in default beyond any notice and cure period under any other lease or agreement with Landlord at the Building or Property. If Landlord provides Tenant with notice of Tenant’s Default under this Lease on 3 separate occasions during any 12 month period, Tenant’s subsequent material Default shall, at Landlord’s option, be an incurable Default by Tenant. All notices sent under this Section shall be in satisfaction of, and not in addition to, notice required by Law.

19. Remedies.

19.01 Upon the occurrence of any Default under this Lease, whether enumerated in Section 18 or not, Landlord shall have the option to pursue any one or more of the following remedies without any notice (except as expressly prescribed herein) or demand whatsoever (and without limiting the generality of the foregoing, Tenant hereby specifically waives notice and demand for payment of Rent or other obligations, except for those notices specifically required pursuant to the terms of Section 18 or this Section 19, and waives any and all other notices or demand requirements imposed by applicable law):

- (a) Terminate this Lease and Tenant’s right to possession of the Premises and recover from Tenant an award of damages equal to the sum of the following:
 - (i) The Worth at the Time of Award of the unpaid Rent which had been earned at the time of termination;
 - (ii) The Worth at the Time of Award of the amount by which the unpaid Rent which would have been earned after termination until the time of award exceeds the amount of such Rent loss that Tenant affirmatively proves could have been reasonably avoided;
 - (iii) The Worth at the Time of Award of the amount by which the unpaid Rent for the balance of the Term after the time of award exceeds the amount of such Rent loss that Tenant affirmatively proves could be reasonably avoided;

- (iv) Any other amount necessary to compensate Landlord for all the detriment either proximately caused by Tenant's failure to perform Tenant's obligations under this Lease or which in the ordinary course of things would be likely to result therefrom; and
- (v) All such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time under applicable law.

The "**Worth at the Time of Award**" of the amounts referred to in parts (i) and (ii) above, shall be computed by allowing interest at the lesser of a per annum rate equal to: (A) the greatest per annum rate of interest permitted from time to time under applicable law, or (B) the Prime Rate plus 5%. For purposes hereof, the "**Prime Rate**" shall be the per annum interest rate publicly announced as its prime or base rate by a federally insured bank selected by Landlord in the State of California. The "**Worth at the Time of Award**" of the amount referred to in part (iii), above, shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus 1%;

- (b) Employ the remedy described in California Civil Code § 1951.4 (Landlord may continue this Lease in effect after Tenant's breach and abandonment and recover Rent as it becomes due, if Tenant has the right to sublet or assign, subject only to reasonable limitations); or
- (c) Notwithstanding Landlord's exercise of the remedy described in California Civil Code § 1951.4 in respect of an event or events of default, at such time thereafter as Landlord may elect in writing, to terminate this Lease and Tenant's right to possession of the Premises and recover an award of damages as provided above in Paragraph 19.01(a).

19.02 The subsequent acceptance of Rent hereunder by Landlord shall not be deemed to be a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, other than the failure of Tenant to pay the particular Rent so accepted, regardless of Landlord's knowledge of such preceding breach at the time of acceptance of such Rent. No waiver by Landlord of any breach hereof shall be effective unless such waiver is in writing and signed by Landlord.

19.03 TENANT HEREBY WAIVES ANY AND ALL RIGHTS CONFERRED BY SECTION 3275 OF THE CIVIL CODE OF CALIFORNIA AND BY SECTIONS 1174 (c) AND 1179 OF THE CODE OF CIVIL PROCEDURE OF CALIFORNIA AND ANY AND ALL OTHER LAWS AND RULES OF LAW FROM TIME TO TIME IN EFFECT DURING THE LEASE TERM PROVIDING THAT TENANT SHALL HAVE ANY RIGHT TO REDEEM, REINSTATE OR RESTORE THIS LEASE FOLLOWING ITS TERMINATION BY REASON OF TENANT'S BREACH. TENANT ALSO HEREBY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, THE RIGHT TO TRIAL BY JURY IN ANY LITIGATION ARISING OUT OF OR RELATING TO THIS LEASE.

19.04 No right or remedy herein conferred upon or reserved to Landlord is intended to be exclusive of any other right or remedy, and each and every right and remedy shall be cumulative and in addition to any other right or remedy given hereunder or now or hereafter existing by agreement, applicable law or in equity. In addition to other remedies provided in this Lease, Landlord shall be entitled, to the extent permitted by applicable law, to injunctive relief, or to a decree compelling performance of any of the covenants, agreements, conditions or provisions of this Lease, or to any other remedy allowed to Landlord at law or in equity. Forbearance by Landlord to enforce one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute a waiver of such default.

19.05 If Tenant is in Default of any of its non-monetary obligations under the Lease, Landlord shall have the right to perform such obligations. Tenant shall reimburse Landlord for the cost of such performance upon demand together with an administrative charge equal to 10% of the cost of the work performed by Landlord.

19.06 This Section 19 shall be enforceable to the maximum extent such enforcement is not prohibited by applicable law, and the unenforceability of any portion thereof shall not thereby render unenforceable any other portion.

20. **Limitation of Liability.**

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED IN THIS LEASE, THE LIABILITY OF LANDLORD (AND OF ANY SUCCESSOR LANDLORD) SHALL BE LIMITED TO THE LESSER OF (A) THE INTEREST OF LANDLORD IN THE PROPERTY, OR (B) THE EQUITY INTEREST LANDLORD WOULD HAVE IN THE PROPERTY IF THE PROPERTY WERE ENCUMBERED BY THIRD PARTY DEBT IN AN AMOUNT EQUAL TO 70% OF THE VALUE OF THE PROPERTY. TENANT SHALL LOOK SOLELY TO LANDLORD'S INTEREST IN THE PROPERTY FOR THE RECOVERY OF ANY JUDGMENT OR AWARD AGAINST LANDLORD OR ANY LANDLORD RELATED PARTY. NEITHER LANDLORD NOR ANY LANDLORD RELATED PARTY SHALL BE PERSONALLY LIABLE FOR ANY JUDGMENT OR DEFICIENCY, AND IN NO EVENT SHALL LANDLORD OR ANY LANDLORD RELATED PARTY BE LIABLE TO TENANT FOR ANY LOST PROFIT, DAMAGE TO OR LOSS OF BUSINESS OR ANY FORM OF SPECIAL, INDIRECT OR CONSEQUENTIAL DAMAGE. BEFORE FILING SUIT FOR AN ALLEGED DEFAULT BY LANDLORD, TENANT SHALL GIVE LANDLORD AND THE MORTGAGEE(S) WHOM TENANT HAS BEEN NOTIFIED HOLD MORTGAGES (DEFINED IN SECTION 23 BELOW), NOTICE AND REASONABLE TIME TO CURE THE ALLEGED DEFAULT.

21. Relocation.

At Landlord's sole cost and expense, at any time before or during the Term, if Landlord reasonably determines it is necessary for the health and safety of Tenant or of other tenants in the Building, Landlord may relocate Tenant from the Premises to space of reasonably comparable size and utility ("**Relocation Space**") within the Building or adjacent buildings within the same project upon 60 days' prior written notice to Tenant. The Relocation Space must contain similar finishes as the Premises, and approximately the same Rentable Square Footage as the Premises and the same number of work stations, offices, breakrooms and reception areas as are contained in the Premises as of the date Tenant receives Landlord's notice of relocation. From and after the date of the relocation, the Base Rent and Tenant's Pro Rata Share shall be adjusted based on the rentable square footage of the Relocation Space. Landlord shall pay Tenant's actual costs of relocation, including all costs for moving Tenant's furniture, equipment, supplies and other personal property, as well as the cost of printing and distributing change of address notices to Tenant's customers and one month's supply of stationery showing the new address, and prior to such relocation, Landlord, at Landlord's cost, shall improve the Relocation Space to incorporate improvements and finishes similar to those incorporated within the Premises (the commercial availability of like or similar materials shall be taken into account in such case, so that Landlord will not be required to duplicate materials or finishes which are no longer readily available on the market, but may instead, with Tenant's consent [not to be unreasonably withheld, conditioned or delayed], substitute reasonable replacement materials or finishes). Notwithstanding anything to the contrary contained herein, Landlord's obligation to pay actual relocation related costs shall be limited to services directly related to the relocation and to products of a quality or grade in use by Tenant prior to such relocation. If Landlord provides Tenant with a notice of relocation and Tenant, in its reasonable judgment, determines that the Relocation Space is not comparable to the Premises, Tenant shall have the right to terminate this Lease by giving written notice of termination to Landlord within 10 days after the date of Landlord's notice of relocation to Tenant. Tenant's notice of termination shall set forth the reasons why Tenant believes the Relocation Space is not comparable to the Premises. Such termination shall be effective 60 days after the date of Landlord's notice of relocation, provided that Landlord, within 10 days after receipt of Tenant's notice of termination, shall have the right to withdraw its notice of relocation. In such event, this Lease shall continue in full force and effect as if Landlord had never provided Tenant with a notice of relocation.

22. Holding Over.

If Tenant fails to surrender all or any part of the Premises at the termination of this Lease, occupancy of the Premises after termination shall be that of a tenancy at sufferance. Tenant's occupancy shall be subject to all the terms and provisions of this Lease, and Tenant shall pay an amount (on a per month basis without reduction for partial months during the holdover) equal to 150% of the sum of the Base Rent and Additional Rent due for the period immediately preceding the holdover. No holdover by Tenant or payment by Tenant after the termination of this Lease shall be construed to extend the Term or prevent Landlord from immediate recovery of possession of the Premises by summary proceedings or otherwise. If Landlord is unable to deliver possession of the Premises to a new tenant or to perform improvements for a new tenant as a result of Tenant's holdover and Tenant fails to vacate the Premises within 15 days after notice from Landlord, Tenant shall be liable for all damages that Landlord suffers from the holdover.

23. Subordination to Mortgages; Estoppel Certificate.

Tenant accepts this Lease subject and subordinate to any mortgage(s), deed(s) of trust, ground lease(s) or other lien(s) now or subsequently arising upon the Premises, the Building or the Property, and to renewals, modifications, refinancings and extensions thereof (collectively referred to as a "**Mortgage**"). The party having the benefit of a Mortgage shall be referred to as a "**Mortgagee**". This clause shall be self-operative, but upon request from a Mortgagee, Tenant shall execute a commercially reasonable subordination agreement in favor of the Mortgagee. As an alternative, a Mortgagee shall have the right at any time to subordinate its Mortgage to this Lease. Upon request, Tenant, without charge, shall attorn to any successor to Landlord's interest in this Lease. Landlord and Tenant shall each, within 10 days after receipt of a written request from the other, execute and deliver a commercially reasonable estoppel certificate to those parties as are reasonably requested by the other (including a Mortgagee or prospective purchaser). Without limitation, such estoppel certificate may include a certification as to the status of this Lease, the existence of any defaults and the amount of Rent that is due and payable. Notwithstanding the foregoing in this Article to the contrary, as a condition precedent to the future subordination of this Lease to a future Mortgage, Landlord shall be required to provide Tenant with a commercially reasonable non-disturbance, subordination, and attornment agreement in favor of Tenant from any Mortgagee who comes into existence after the Commencement Date. Landlord represents and warrants that, as of the date of this Lease, the Property is not encumbered by a Mortgage.

24. Notice.

All demands, approvals, consents or notices (collectively referred to as a “**notice**”) shall be in writing and delivered by hand or sent by registered or certified mail with return receipt requested or sent by overnight or same day courier service at the party’s respective Notice Address(es) set forth in Section 1. Each notice shall be deemed to have been received on the earlier to occur of actual delivery or the date on which delivery is refused, or, if Tenant has vacated the Premises or any other Notice Address of Tenant without providing a new Notice Address, 3 days after notice is deposited in the U.S. mail or with a courier service in the manner described above. Either party may, at any time, change its Notice Address (other than to a post office box address) by giving the other party written notice of the new address.

25. Surrender of Premises.

At the termination of this Lease or Tenant’s right of possession, Tenant shall remove Tenant’s Property from the Premises, and quit and surrender the Premises to Landlord, broom clean, and in good order, condition and repair, ordinary wear and tear and damage which Landlord is obligated to repair hereunder excepted. If Tenant fails to remove any of Tenant’s Property within 2 days after termination of this Lease or Tenant’s right to possession, Landlord, at Tenant’s sole cost and expense, shall be entitled (but not obligated) to remove and store Tenant’s Property. Landlord shall not be responsible for the value, preservation or safekeeping of Tenant’s Property. Tenant shall pay Landlord, upon demand, the expenses and storage charges incurred. If Tenant fails to remove Tenant’s Property from the Premises or storage, within 30 days after notice, Landlord may deem all or any part of Tenant’s Property to be abandoned and title to Tenant’s Property shall vest in Landlord.

26. Miscellaneous.

26.01 This Lease shall be interpreted and enforced in accordance with the Laws of the state or commonwealth in which the Building is located without respect to conflicts of laws principles, and Landlord and Tenant hereby irrevocably consent to the jurisdiction and proper venue of such state or commonwealth. If any term or provision of this Lease shall to any extent be void or unenforceable, the remainder of this Lease shall not be affected. If there is more than one Tenant or if Tenant is comprised of more than one party or entity, the obligations imposed upon Tenant shall be joint and several obligations of all the parties and entities, and requests or demands from any one person or entity comprising Tenant shall be deemed to have been made by all such persons or entities. Notices to any one person or entity shall be deemed to have been given to all persons and entities. Tenant represents and warrants to Landlord that each individual executing this Lease on behalf of Tenant is authorized to do so on behalf of Tenant and that Tenant is not, and the entities or individuals constituting Tenant or which may own or control Tenant or which may be owned or controlled by Tenant are not, (i) in violation of any laws relating to terrorism or money laundering, or (ii) among the individuals or entities identified on any list compiled pursuant to Executive Order 13224 for the purpose of identifying suspected terrorists or on the most current list published by the U.S. Treasury Department Office of Foreign Assets Control at its official website, <http://www.treas.gov/ofac/tltsdn.pdf> or any replacement website or other replacement official publication of such list.

26.02 If either party institutes a suit against the other for violation of or to enforce any covenant, term or condition of this Lease, the prevailing party shall be entitled to reimbursement of all of its costs and expenses, including, without limitation, reasonable attorneys’ fees. Landlord and Tenant hereby waive any right to trial by jury in any proceeding based upon a breach of this Lease. Either party’s failure to declare a default immediately upon its occurrence, or delay in taking action for a default, shall not constitute a waiver of the default, nor shall it constitute an estoppel.

26.03 Whenever a period of time is prescribed for the taking of an action by Landlord or Tenant (other than the payment of the Security Deposit or Rent), the period of time for the performance of such action shall be extended by the number of days that the performance is actually delayed due to strikes, acts of God, shortages of labor or materials, war, terrorist acts, civil disturbances and other causes beyond the reasonable control of the performing party (“**Force Majeure**”).

26.04 Landlord shall have the right to transfer and assign, in whole or in part, all of its rights and obligations under this Lease and in the Building and Property. Upon transfer Landlord shall be released from any further obligations hereunder and Tenant agrees to look solely to the successor in interest of Landlord for the performance of such obligations, provided that, any successor pursuant to a voluntary, third party transfer (but not as part of an involuntary transfer resulting from a foreclosure or deed in lieu thereof) shall be deemed to have assumed Landlord's obligations under this Lease either by written contractual obligation, assumption agreement or by operation of Law.

26.05 Landlord has delivered a copy of this Lease to Tenant for Tenant's review only and the delivery of it does not constitute an offer to Tenant or an option. Tenant represents that it has dealt directly with and only with the Broker as a broker in connection with this Lease. Tenant shall indemnify and hold Landlord and the Landlord Related Parties harmless from all claims of any other brokers claiming to have represented Tenant in connection with this Lease. Landlord shall indemnify and hold Tenant and the Tenant Related Parties harmless from all claims of any brokers claiming to have represented Landlord in connection with this Lease. Equity Office Properties Management Corp. ("EOPMC") is an affiliate of Landlord and represents only the Landlord in this transaction. Any assistance rendered by any agent or employee of EOPMC in connection with this Lease or any subsequent amendment or modification hereto has been or will be made as an accommodation to Tenant solely in furtherance of consummating the transaction on behalf of Landlord, and not as agent for Tenant.

26.06 Time is of the essence with respect to Tenant's exercise of any expansion, renewal or extension rights granted to Tenant. The expiration of the Term, whether by lapse of time, termination or otherwise, shall not relieve either party of any obligations which accrued prior to or which may continue to accrue after the expiration or termination of this Lease.

26.07 Tenant may peacefully have, hold and enjoy the Premises, subject to the terms of this Lease, provided Tenant pays the Rent and fully performs all of its covenants and agreements. This covenant shall be binding upon Landlord and its successors only during its or their respective periods of ownership of the Building.

26.08 This Lease does not grant any rights to light or air over or about the Building. Landlord excepts and reserves exclusively to itself any and all rights not specifically granted to Tenant under this Lease. This Lease constitutes the entire agreement between the parties and supersedes all prior agreements and understandings related to the Premises, including all lease proposals, letters of intent and other documents. Neither party is relying upon any warranty, statement or representation not contained in this Lease. This Lease may be modified only by a written agreement signed by an authorized representative of Landlord and Tenant.

[SIGNATURES ARE ON FOLLOWING PAGE]

Landlord and Tenant have executed this Lease as of the day and year first above written.

LANDLORD:

**CA-GATEWAY OFFICE LIMITED PARTNERSHIP, a
Delaware limited partnership**

By: EOM GP, L.L.C., a Delaware limited liability company, its
general partner

By: Equity Office Management, L.L.C., a Delaware
limited liability company, its non-member manager

By: /s/ Richard Scott

Name: Richard Scott

Title: Regional Vice President - Leasing

TENANT:

**AUDIOCODES, INC.,
a Delaware corporation**

By: AudioCodes, Inc.

Name: Nachum Falek

Title: CFO

Tenant's Tax ID Number (SSN or FEIN):

77 - 0448588

EXHIBIT A

OUTLINE AND LOCATION OF PREMISES

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

EXHIBIT B

EXPENSES AND TAXES

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** ("Landlord") and **AUDIOCODES, INC.** ("Tenant") for space in the Building located at 2099 Gateway Place, San Jose, California.

1. Payments.

1.01 Tenant shall pay Tenant's Pro Rata Share of the amount, if any, by which Expenses (defined below) for each calendar year during the Term exceed Expenses for the Base Year (the "**Expense Excess**") and also the amount, if any, by which Taxes (defined below) for each calendar year during the Term exceed Taxes for the Base Year (the "**Tax Excess**"). If Expenses or Taxes in any calendar year decrease below the amount of Expenses or Taxes for the Base Year, Tenant's Pro Rata Share of Expenses or Taxes, as the case may be, for that calendar year shall be \$0. Landlord shall provide Tenant with a good faith estimate of the Expense Excess and of the Tax Excess for each calendar year during the Term. On or before the first day of each month, Tenant shall pay to Landlord a monthly installment equal to one-twelfth of Tenant's Pro Rata Share of Landlord's estimate of both the Expense Excess and Tax Excess. After its receipt of the revised estimate, Tenant's monthly payments shall be based upon the revised estimate. If Landlord does not provide Tenant with an estimate of the Expense Excess or the Tax Excess by January 1 of a calendar year, Tenant shall continue to pay monthly installments based on the previous year's estimate(s) until Landlord provides Tenant with the new estimate.

1.02 As soon as is practical following the end of each calendar year, Landlord shall furnish Tenant with a statement of the actual Expenses and Expense Excess and the actual Taxes and Tax Excess for the prior calendar year. If the estimated Expense Excess or estimated Tax Excess for the prior calendar year is more than the actual Expense Excess or actual Tax Excess, as the case may be, for the prior calendar year, Landlord shall either provide Tenant with a refund or apply any overpayment by Tenant against Additional Rent due or next becoming due, provided if the Term expires before the determination of the overpayment, Landlord shall refund any overpayment to Tenant after first deducting the amount of Rent due. If the estimated Expense Excess or estimated Tax Excess for the prior calendar year is less than the actual Expense Excess or actual Tax Excess, as the case may be, for such prior year, Tenant shall pay Landlord, within 30 days after its receipt of the statement of Expenses or Taxes, any underpayment for the prior calendar year.

2. Expenses.

2.01 "**Expenses**" means all costs and expenses incurred in each calendar year in connection with operating, maintaining, repairing, and managing the Building and the Property. Expenses include, without limitation: (a) all labor and labor related costs, including wages, salaries, bonuses, taxes, insurance, uniforms, training, retirement plans, pension plans and other employee benefits; (b) management fees; (c) the cost of equipping, staffing and operating an on-site and/or off-site management office for the Building, provided if the management office services one or more other buildings or properties, the shared costs and expenses of equipping, staffing and operating such management office(s) shall be equitably prorated and apportioned between the Building and the other buildings or properties; (d) accounting costs; (e) the cost of services; (f) rental and purchase cost of parts, supplies, tools and equipment; (g) insurance premiums and deductibles; (h) electricity, gas and other utility costs; and (i) the amortized cost of capital improvements (as distinguished from replacement parts or components installed in the ordinary course of business) made subsequent to the Base Year which are: (1) performed primarily to reduce current or future operating expense costs, upgrade Building security or otherwise improve the operating efficiency of the Property; or (2) required to comply with any Laws that are enacted, or first interpreted to apply to the Property, after the date of this Lease. The cost of capital improvements shall be amortized by Landlord over the lesser of the Payback Period (defined below) or the useful life of the capital improvement as reasonably determined by Landlord. The amortized cost of capital improvements may, at Landlord's option, include actual or imputed interest at the rate that Landlord would reasonably be required to pay to finance the cost of the capital improvement. "**Payback Period**" means the reasonably estimated period of time that it takes for the cost savings resulting from a capital improvement to equal the total cost of the capital improvement. Landlord, by itself or through an affiliate, shall have the right to directly perform, provide and be compensated for any services under this Lease. If Landlord incurs Expenses for the Building or Property together with one or more other buildings or properties, whether pursuant to a reciprocal easement agreement, common area agreement or otherwise, the shared costs and expenses shall be equitably prorated and apportioned between the Building and Property and the other buildings or properties.

2.02 Expenses shall not include:

- (a) the cost of capital improvements (except as set forth above);
- (b) depreciation; payments of principal, interest, points or fees on any mortgage and other non-operating debts of Landlord;
- (c) the cost of repairs or other work to the extent Landlord is reimbursed by insurance or condemnation proceeds;
- (d) costs in connection with leasing space in the Building, including brokerage commissions; lease concessions, rental abatements and construction allowances granted to specific tenants;
- (e) costs incurred in connection with the sale, financing or refinancing of the Building;
- (f) fines, interest and penalties incurred due to the late payment of Taxes or Expenses;
- (g) organizational expenses associated with the creation and operation of the entity which constitutes Landlord;
- (h) any penalties or damages that Landlord pays to Tenant under this Lease or to other tenants in the Building under their respective leases;
- (i) any ground lease rental;
- (j) rentals for items (except when needed in connection with normal repairs and maintenance of permanent systems) which, if purchased rather than rented, would constitute a capital improvement which is specifically excluded in (a) above, excluding, however, equipment not affixed to the Building which is used in providing janitorial or similar services;
- (k) costs, including permit, license and inspection costs incurred with respect to the installation of tenant or other occupants' improvements in the Building, or incurred in renovating or otherwise improving, decorating, painting or redecorating vacant leaseable space for tenants or other occupants of the Building, except in connection with general maintenance and repairs provided to tenants of the Building in general;
- (l) expenses in connection with services or other benefits which are not offered to Tenant or for which Tenant is charged for directly, but which are provided to another tenant or occupant of the Building;
- (m) expenses in connection with utilities, services or other services which are provided to Tenant or another tenant or occupant of the Building to the extent Tenant or such other tenant or occupant reimburses Landlord fully for such utilities, services or benefits;
- (n) attorney's fees and other costs incurred by Landlord in litigating or otherwise resolving any dispute with another tenant of the Building over any alleged violation by Landlord or any tenant of the Building of the terms and conditions of any lease to which it is a party and covering space in the Building;
- (o) overhead and profit increment paid to Landlord or to subsidiaries or affiliates of Landlord for goods or services in or to the Building to the extent the same exceeds the cost (including overhead and profits) of such goods or services of equal quality rendered by unaffiliated third parties on a competitive basis;
- (p) any and all costs arising from the presence of "hazardous substances" in or about the Building on the Commencement Date, including without limitation, hazardous substances in the ground water or soil, except to the extent such removal, cleaning, abatement or remediation is related to the general repair and maintenance of the Building, Common Area or Property;
- (q) costs arising from Landlord's charitable or political contributions; and
- (r) costs (including in connection therewith all attorneys' fees and costs of settlement, judgements and payments in lieu thereof) arising from claims, disputes or potential disputes in connection with potential or actual claims of litigation or arbitration pertaining to Landlord or Landlord's interest in or title to the Building.

2.03 If at any time during a calendar year the Building is not at least 95% occupied or Landlord is not supplying services to at least 95% of the total Rentable Square Footage of the Building, Expenses shall, at Landlord's option, be determined as if the Building had been 95% occupied and Landlord had been supplying services to 95% of the Rentable Square Footage of the Building. If Expenses for a calendar year are determined as provided in the prior sentence, Expenses for the Base Year shall also be determined in such manner. Notwithstanding the foregoing, Landlord may calculate the extrapolation of Expenses under this Section based on 100% occupancy and service so long as such percentage is used consistently for each year of the Term. The extrapolation of Expenses under this Section shall be performed in accordance with the methodology specified by the Building Owners and Managers Association.

3. "**Taxes**" shall mean: (a) all real property taxes and other assessments on the Building and/or Property, including, but not limited to, gross receipts taxes, assessments for special improvement districts and building improvement districts, governmental charges, fees and assessments for police, fire, traffic mitigation or other governmental service of purported benefit to the Property, taxes and assessments levied in substitution or supplementation in whole or in part of any such taxes and assessments and the Property's share of any real estate taxes and assessments under any reciprocal easement agreement, common area agreement or similar agreement as to the Property; (b) all personal property taxes for property that is owned by Landlord and used in connection with the operation, maintenance and repair of the Property; and (c) all costs and fees incurred in connection with seeking reductions in any tax liabilities described in (a) and (b), including, without limitation, any costs incurred by Landlord for compliance, review and appeal of tax liabilities. Without limitation, Taxes shall not include any income, capital levy, transfer, capital stock, gift, estate or inheritance tax. If a change in Taxes is obtained for any year of the Term during which Tenant paid Tenant's Pro Rata Share of any Tax Excess, then Taxes for that year will be retroactively adjusted and Landlord shall provide Tenant with a credit, if any, based on the adjustment. Likewise, if a change is obtained for Taxes for the Base Year, Taxes for the Base Year shall be restated and the Tax Excess for all subsequent years shall be recomputed. Tenant shall pay Landlord the amount of Tenant's Pro Rata Share of any such increase in the Tax Excess within 30 days after Tenant's receipt of a statement from Landlord.

4. **Audit Rights.** Tenant, within 365 days after receiving Landlord's statement of Expenses, may give Landlord written notice ("**Review Notice**") that Tenant intends to review Landlord's records of the Expenses for the calendar year to which the statement applies. Within a reasonable time after receipt of the Review Notice, Landlord shall make all pertinent records available for inspection that are reasonably necessary for Tenant to conduct its review. If any records are maintained at a location other than the management office for the Building, Tenant may either inspect the records at such other location or pay for the reasonable cost of copying and shipping the records. If Tenant retains an agent to review Landlord's records, the agent must be with a CPA firm licensed to do business in the state or commonwealth where the Property is located. Tenant shall be solely responsible for all costs, expenses and fees incurred for the audit. Within 90 days after the records are made available to Tenant, Tenant shall have the right to give Landlord written notice (an "**Objection Notice**") stating in reasonable detail any objection to Landlord's statement of Expenses for that year. If Tenant fails to give Landlord an Objection Notice within the 90 day period or fails to provide Landlord with a Review Notice within the 365 day period described above, Tenant shall be deemed to have approved Landlord's statement of Expenses and shall be barred from raising any claims regarding the Expenses for that year. If Tenant provides Landlord with a timely Objection Notice, Landlord and Tenant shall work together in good faith to resolve any issues raised in Tenant's Objection Notice. If Landlord and Tenant determine that Expenses for the calendar year are less than reported, Landlord shall provide Tenant with a credit against the next installment of Rent in the amount of the overpayment by Tenant. Likewise, if Landlord and Tenant determine that Expenses for the calendar year are greater than reported, Tenant shall pay Landlord the amount of any underpayment within 30 days. The records obtained by Tenant shall be treated as confidential. In no event shall Tenant be permitted to examine Landlord's records or to dispute any statement of Expenses unless Tenant has paid and continues to pay all Rent when due.

EXHIBIT C

WORK LETTER

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

As used in this Workletter, the “Premises” shall be deemed to mean the Premises, as initially defined in the attached Lease.

1. Landlord shall perform improvements to the Premises substantially in accordance with the space plan prepared by Reel Grobman dated November 19, 2004 and the construction bid prepared by McLarney Construction dated November 29, 2004 (collectively, the “Plans”). The improvements to be performed by Landlord in accordance with the Plans are hereinafter referred to as the “**Landlord Work**.” It is agreed that construction of the Landlord Work will be completed at Landlord’s sole cost and expense (subject to the terms of Section 2 below) using Building standard methods, materials and finishes. Landlord shall enter into a direct contract for the Landlord Work with a general contractor selected by Landlord. In addition, Landlord shall have the right to select and/or approve of any subcontractors used in connection with the Landlord Work. Landlord’s supervision or performance of any work for or on behalf of Tenant shall not be deemed a representation by Landlord that such Plans or the revisions thereto comply with applicable insurance requirements, building codes, ordinances, laws or regulations, or that the improvements constructed in accordance with the Plans and any revisions thereto will be adequate for Tenant’s use, it being agreed that Tenant shall be responsible for all elements of the design of Tenant’s plans (including, without limitation, compliance with law, functionality of design, the structural integrity of the design, the configuration of the premises and the placement of Tenant’s furniture, appliances and equipment).
2. If Tenant shall request any revisions to the Plans, Landlord shall have such revisions prepared at Tenant’s sole cost and expense and Tenant shall reimburse Landlord for the cost of preparing any such revisions to the Plans, plus any applicable state sales or use tax thereon, upon demand. Promptly upon completion of the revisions, Landlord shall notify Tenant in writing of the increased cost in the Landlord Work, if any, resulting from such revisions to the Plans. Tenant, within one Business Day, shall notify Landlord in writing whether it desires to proceed with such revisions. In the absence of such written authorization, Landlord shall have the option to continue work on the Premises disregarding the requested revision. Tenant shall be responsible for any Tenant Delay in completion of the Premises resulting from any revision to the Plans. If such revisions result in an increase in the cost of Landlord Work, such increased costs, plus any applicable state sales or use tax thereon, shall be payable by Tenant upon demand. Notwithstanding anything herein to the contrary, all revisions to the Plans shall be subject to the approval of Landlord.
3. Landlord acknowledges that the Commencement Date shall not occur until the Landlord Work is Substantially Complete as provided in Section 3 of the Lease, and Landlord shall use commercially reasonable efforts to complete any “punch list” items as soon as reasonably possible after the Commencement Date. Tenant acknowledges that such punch list items may be performed by Landlord in the Premises during Building Service Hours subsequent to the Commencement Date if required by scheduling of contractors and subcontractors and other factors reasonably outside of Landlord’s control. Landlord and Tenant agree to cooperate with each other in order to enable the Landlord Work to be performed in a timely manner and with as little inconvenience to the operation of Tenant’s business as is reasonably possible. Notwithstanding anything herein to the contrary, any delay in the completion of the Landlord Work or inconvenience suffered by Tenant during the performance of the Landlord Work shall not delay the Commencement Date nor shall it subject Landlord to any liability for any loss or damage resulting therefrom or entitle Tenant to any credit, abatement or adjustment of Rent or other sums payable under the Lease.
4. This Exhibit shall not be deemed applicable to any additional space added to the Premises at any time or from time to time, whether by any options under the Lease or otherwise, or to any portion of the original Premises or any additions to the Premises in the event of a renewal or extension of the original Term of the Lease, whether by any options under the Lease or otherwise, unless expressly so provided in the Lease or any amendment or supplement to the Lease.

EXHIBIT D

COMMENCEMENT LETTER

(EXAMPLE)

Date _____

Tenant AudioCodes, Inc.
Address _____

Re: Commencement Letter with respect to that certain Lease dated as of the ____ day of _____, 200__, by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP**, as Landlord, and **AUDIOCODES, INC.**, as Tenant, for 7,356 rentable square feet on the fifth floor of the Building located at 2099 Gateway Place, San Jose, California.

Lease Id: _____
Business Unit Number: _____

Dear _____:

In accordance with the terms and conditions of the above referenced Lease, Tenant accepts possession of the Premises and agrees:

1. The Commencement Date of the Lease is _____;
2. The Termination Date of the Lease is _____.

Please acknowledge your acceptance of possession and agreement to the terms set forth above by signing all 3 counterparts of this Commencement Letter in the space provided and returning 2 fully executed counterparts to my attention. Tenant's failure to execute and return this letter, or to provide written objection to the statements contained in this letter, within 30 days after the date of this letter shall be deemed an approval by Tenant of the statements contained herein.

Sincerely,

Authorized Signatory

Agreed and Accepted:

Tenant: AudioCodes, Inc.,
a Delaware corporation

By: _____
Name: _____
Title: _____
Date: _____

EXHIBIT E

BUILDING RULES AND REGULATIONS

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

The following rules and regulations shall apply, where applicable, to the Premises, the Building, the parking facilities (if any), the Property and the appurtenances. In the event of a conflict between the following rules and regulations and the remainder of the terms of the Lease, the remainder of the terms of the Lease shall control. Capitalized terms have the same meaning as defined in the Lease.

1. Sidewalks, doorways, vestibules, halls, stairways and other similar areas shall not be obstructed by Tenant or used by Tenant for any purpose other than ingress and egress to and from the Premises. No rubbish, litter, trash, or material shall be placed, emptied, or thrown in those areas. At no time shall Tenant permit Tenant’s employees to loiter in Common Areas or elsewhere about the Building or Property.
2. Plumbing fixtures and appliances shall be used only for the purposes for which designed and no sweepings, rubbish, rags or other unsuitable material shall be thrown or placed in the fixtures or appliances. Damage resulting to fixtures or appliances due to the gross negligence or willful misconduct of Tenant, its agents, employees or invitees shall be paid for by Tenant and Landlord shall not be responsible for the damage.
3. No signs, advertisements or notices shall be painted or affixed to windows, doors or other parts of the Building, except those of such color, size, style and in such places as are first approved in writing by Landlord. All tenant identification and suite numbers at the entrance to the Premises shall be installed by Landlord, at Tenant’s cost and expense, using the standard graphics for the Building. Except in connection with the hanging of lightweight pictures and wall decorations, no nails, hooks or screws shall be inserted into any part of the Premises or Building except by the Building maintenance personnel without Landlord’s prior approval, which approval shall not be unreasonably withheld.
4. Landlord may provide and maintain in the first floor (main lobby) of the Building an alphabetical directory board or other directory device listing tenants and no other directory shall be permitted unless previously consented to by Landlord in writing.
5. Tenant shall not place any lock(s) on any door in the Premises or Building without Landlord’s prior written consent, which consent shall not be unreasonably withheld, and Landlord shall have the right at all times to retain and use keys or other access codes or devices to all locks within and into the Premises. A reasonable number of keys to the locks on the entry doors in the Premises shall be furnished by Landlord to Tenant at Tenant’s cost and Tenant shall not make any duplicate keys. All keys shall be returned to Landlord at the expiration or early termination of the Lease.
6. All contractors, contractor’s representatives and installation technicians performing work in the Building shall be subject to Landlord’s prior approval, which approval shall not be unreasonably withheld, and shall be required to comply with Landlord’s standard rules, regulations, policies and procedures, which may be revised from time to time.
7. Movement in or out of the Building of furniture or office equipment, or dispatch or receipt by Tenant of merchandise or materials requiring the use of elevators, stairways, lobby areas or loading dock areas, shall be restricted to hours reasonably designated by Landlord. Tenant shall obtain Landlord’s prior approval by providing a detailed listing of the activity, which approval shall not be unreasonably withheld. If approved by Landlord, the activity shall be under the supervision of Landlord and performed in the manner required by Landlord. Tenant shall assume all risk for damage to articles moved and injury to any persons resulting from the activity. If equipment, property, or personnel of Landlord or of any other party is damaged or injured as a result of or in connection with the activity, Tenant shall be solely liable for any resulting damage, loss or injury.
8. Landlord shall have the right to approve the weight, size, or location of heavy equipment or articles in and about the Premises, which approval shall not be unreasonably withheld. Damage to the Building by the installation, maintenance, operation, existence or removal of Tenant’s Property shall be repaired at Tenant’s sole expense.

9. Corridor doors, when not in use, shall be kept closed.
10. Tenant shall not: (1) make or permit any improper, objectionable or unpleasant noises or odors in the Building, or otherwise interfere in any way with other tenants or persons having business with them; (2) solicit business or distribute or cause to be distributed, in any portion of the Building, handbills, promotional materials or other advertising; or (3) conduct or permit other activities in the Building that might, in Landlord's sole opinion, constitute a nuisance.
11. No animals, except those assisting handicapped persons, shall be brought into the Building or kept in or about the Premises.
12. No inflammable, explosive or dangerous fluids or substances shall be used or kept by Tenant in the Premises, Building or about the Property, except for those substances as are typically found in similar premises used for general office purposes and are being used by Tenant in a safe manner and in accordance with all applicable Laws. Tenant shall not, without Landlord's prior written consent, use, store, install, spill, remove, release or dispose of, within or about the Premises or any other portion of the Property, any asbestos-containing materials or any solid, liquid or gaseous material now or subsequently considered toxic or hazardous under the provisions of 42 U.S.C. Section 9601 et seq. or any other applicable environmental Law which may now or later be in effect. Tenant shall comply with all Laws pertaining to and governing the use of these materials by Tenant and shall remain solely liable for the costs of abatement and removal.
13. Tenant shall not use or occupy the Premises in any manner or for any purpose which might injure the reputation or impair the present or future value of the Premises or the Building. Tenant shall not use, or permit any part of the Premises to be used for lodging, sleeping or for any illegal purpose.
14. Tenant shall not take any action which would violate Landlord's labor contracts or which would cause a work stoppage, picketing, labor disruption or dispute or interfere with Landlord's or any other tenant's or occupant's business or with the rights and privileges of any person lawfully in the Building ("**Labor Disruption**"). Tenant shall take the actions necessary to resolve the Labor Disruption, and shall have pickets removed and, at the request of Landlord, immediately terminate any work in the Premises that gave rise to the Labor Disruption, until Landlord gives its written consent for the work to resume. Tenant shall have no claim for damages against Landlord or any of the Landlord Related Parties nor shall the Commencement Date of the Term be extended as a result of the above actions.
15. Tenant shall not install, operate or maintain in the Premises or in any other area of the Building, electrical equipment that would overload the electrical system beyond its capacity for proper, efficient and safe operation as determined solely by Landlord. Tenant shall not furnish cooling or heating to the Premises, including, without limitation, the use of electric or gas heating devices, without Landlord's prior written consent. Tenant shall not use more than its proportionate share of telephone lines and other telecommunication facilities available to service the Building.
16. Tenant shall not operate or permit to be operated a coin or token operated vending machine or similar device (including, without limitation, telephones, lockers, toilets, scales, amusement devices and machines for sale of beverages, foods, candy, cigarettes and other goods), except for machines for the exclusive use of Tenant's employees and invitees.
17. Bicycles and other vehicles are not permitted inside the Building or on the walkways outside the Building, except in areas designated by Landlord.
18. Landlord may from time to time adopt systems and procedures for the security and safety of the Building and Property, its occupants, entry, use and contents. Tenant, its agents, employees, contractors, guests and invitees shall comply with Landlord's systems and procedures.
19. Landlord shall have the right to prohibit the use of the name of the Building or any other publicity by Tenant that in Landlord's sole opinion may impair the reputation of the Building or its desirability. Upon written notice from Landlord, Tenant shall refrain from and discontinue such publicity immediately.
20. Neither Tenant nor its agents, employees, contractors, guests or invitees shall smoke or permit smoking in the Common Areas, unless a portion of the Common Areas have been declared a designated smoking area by Landlord, nor shall the above parties allow smoke from the Premises to emanate into the Common Areas or any other part of the Building. Landlord shall have the right to designate the Building (including the Premises) as a non-smoking building.

21. Landlord shall have the right to designate and approve standard window coverings for the Premises and to establish rules to assure that the Building presents a uniform exterior appearance. Tenant shall ensure, to the extent reasonably practicable, that window coverings are closed on windows in the Premises while they are exposed to the direct rays of the sun.
22. Deliveries to and from the Premises shall be made only at the times in the areas and through the entrances and exits reasonably designated by Landlord. Tenant shall not make deliveries to or from the Premises in a manner that might interfere with the use by any other tenant of its premises or of the Common Areas, any pedestrian use, or any use which is inconsistent with good business practice.
23. The work of cleaning personnel shall not be hindered by Tenant after 5:30 P.M., and cleaning work may be done at any time when the offices are vacant. Windows, doors and fixtures may be cleaned at any time. Tenant shall provide adequate waste and rubbish receptacles to prevent unreasonable hardship to the cleaning service.

EXHIBIT F

ADDITIONAL PROVISIONS

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

1. **Asbestos Notification.** Tenant acknowledges that Tenant has received the asbestos notification letter attached to this Lease as **Exhibit H** hereto, disclosing the existence of asbestos in the Building. As part of Tenant’s obligations under this Lease, Tenant agrees to comply with the California “Connelly Act” and other applicable Laws, including providing copies of Landlord’s asbestos notification letter to all of Tenant’s “employees” and “owners”, as those terms are defined in the Connelly Act and other applicable Laws.

2. **Renewal Option.**
 - A. **Grant of Option; Conditions.** Tenant shall have the right to extend the Term (the “**Renewal Option**”) for one additional period of five (5) years commencing on the day following the Termination Date of the initial Term and ending on the fifth anniversary of the Termination Date (the “**Renewal Term**”), if:
 1. Landlord receives notice of exercise (“**Initial Renewal Notice**”) not less than 9 full calendar months prior to the expiration of the initial Term and not more than 12 full calendar months prior to the expiration of the initial Term; and
 2. Tenant is not in default under the Lease beyond any applicable cure periods at the time that Tenant delivers its Initial Renewal Notice or at the time Tenant delivers its Binding Notice (as defined below); and
 3. Not more than 20% of the original Premises is sublet (other than pursuant to a Permitted Transfer, as defined in Section 11 of the Lease) at the time that Tenant delivers its Initial Renewal Notice or at the time Tenant delivers its Binding Notice; and
 4. The Lease has not been assigned (other than pursuant to a Permitted Transfer, as defined in Section 11 of the Lease) prior to the date that Tenant delivers its Initial Renewal Notice or prior to the date Tenant delivers its Binding Notice.

 - B. **Terms Applicable to Premises During Renewal Term.**
 1. The initial Base Rent rate per rentable square foot for the Premises during the Renewal Term shall equal the Prevailing Market (hereinafter defined) rate per rentable square foot for the Premises. Base Rent during the Renewal Term shall increase, if at all, in accordance with the increases assumed in the determination of Prevailing Market rate. Base Rent attributable to the Premises shall be payable in monthly installments in accordance with the terms and conditions of Section 4 of the Lease.
 2. Tenant shall pay Additional Rent (i.e. Taxes and Expenses) for the Premises during the Renewal Term in accordance with Section 4 of the Lease, and the manner and method in which Tenant reimburses Landlord for Tenant’s share of Taxes and Expenses and the Base Year, if any, applicable to such matter, shall be some of the factors considered in determining the Prevailing Market rate for the Renewal Term.

C. Initial Procedure for Determining Prevailing Market. Within 30 days after receipt of Tenant's Initial Renewal Notice, Landlord shall advise Tenant of the applicable Base Rent rate for the Premises for the Renewal Term. Tenant, within 15 days after the date on which Landlord advises Tenant of the applicable Base Rent rate for the Renewal Term, shall either (i) give Landlord final binding written notice ("**Binding Notice**") of Tenant's exercise of its Renewal Option, or (ii) if Tenant disagrees with Landlord's determination, provide Landlord with written notice of rejection (the "**Rejection Notice**"). If Tenant fails to provide Landlord with either a Binding Notice or Rejection Notice within such 15 day period, Tenant's Renewal Option shall be null and void and of no further force and effect. If Tenant provides Landlord with a Binding Notice, Landlord and Tenant shall enter into the Renewal Amendment (as defined below) upon the terms and conditions set forth herein. If Tenant provides Landlord with a Rejection Notice, Landlord and Tenant shall work together in good faith to agree upon the Prevailing Market rate for the Premises during the Renewal Term. When Landlord and Tenant have agreed upon the Prevailing Market rate for the Premises, such agreement shall be reflected in a written agreement between Landlord and Tenant, whether in a letter or otherwise, and Landlord and Tenant shall enter into the Renewal Amendment in accordance with the terms and conditions hereof. Notwithstanding the foregoing, if Landlord and Tenant are unable to agree upon the Prevailing Market rate for the Premises within 30 days after the date Tenant provides Landlord with the Rejection Notice, Tenant, by written notice to Landlord (the "**Arbitration Notice**") at any time after the expiration of such 30 day period but before the date that is 6 months prior to the expiration of the initial Term, shall have the right to have the Prevailing Market rate determined in accordance with the arbitration procedures described in Section D below. If Landlord and Tenant are unable to agree upon the Prevailing Market rate for the Premises within the 30 day period described and Tenant fails to timely exercise its right to arbitrate, Tenant's Renewal Option shall be deemed to be null and void and of no further force and effect.

D. Arbitration Procedure.

1. If Tenant provides Landlord with an Arbitration Notice, Landlord and Tenant, within 5 days after the date of the Arbitration Notice, shall each simultaneously submit to the other, in a sealed envelope, its good faith estimate of the Prevailing Market rate for the Premises during the Renewal Term (collectively referred to as the "Estimates"). If the higher of such Estimates is not more than 105% of the lower of such Estimates, then Prevailing Market rate shall be the average of the two Estimates. If the Prevailing Market rate is not resolved by the exchange of Estimates, then, within 7 days after the exchange of Estimates, Landlord and Tenant shall each select an appraiser to determine which of the two Estimates most closely reflects the Prevailing Market rate for the Premises during the Renewal Term. Each appraiser so selected shall be certified as an MAI appraiser or as an ASA appraiser and shall have had at least 5 years experience within the previous 10 years as a real estate appraiser working in the San Jose, California area, with working knowledge of current rental rates and practices. For purposes hereof, an "**MAI**" appraiser means an individual who holds an MAI designation conferred by, and is an independent member of, the American Institute of Real Estate Appraisers (or its successor organization, or in the event there is no successor organization, the organization and designation most similar), and an "**ASA**" appraiser means an individual who holds the Senior Member designation conferred by, and is an independent member of, the American Society of Appraisers (or its successor organization, or in the event there is no successor organization, the organization and designation most similar).
2. Upon selection, Landlord's and Tenant's appraisers shall work together in good faith to agree upon which of the two Estimates most closely reflects the Prevailing Market rate for the Premises. The Estimate chosen by such appraisers shall be binding on both Landlord and Tenant as the Base Rent rate for the Premises during the Renewal Term. If either Landlord or Tenant fails to appoint an appraiser within the 7 day period referred to above, the appraiser appointed by the other party shall be the sole appraiser for the purposes hereof. If the two appraisers cannot agree upon which of the two Estimates most closely reflects the Prevailing Market within 20 days after their appointment, then, within 10 days after the expiration of such 20 day period, the two appraisers shall select a third appraiser meeting the aforementioned criteria. Once the third appraiser (i.e. arbitrator) has been selected as provided for above, then, as soon thereafter as practicable but in any case within 14 days, the arbitrator shall make his determination of which of the two Estimates most closely reflects the Prevailing Market rate and such Estimate shall be binding on both Landlord and Tenant as the Base Rent rate for the Premises. If the arbitrator believes that expert advice would materially assist him, he may retain one or more qualified persons to provide such expert advice. The parties shall share equally in the costs of the arbitrator and of any experts retained by the arbitrator. Any fees of any appraiser, counsel or experts engaged directly by Landlord or Tenant, however, shall be borne by the party retaining such appraiser, counsel or expert.

3. If the Prevailing Market rate has not been determined by the commencement date of the Renewal Term, Tenant shall pay Base Rent upon the terms and conditions in effect during the last month of the initial Term for the Premises until such time as the Prevailing Market rate has been determined. Upon such determination, the Base Rent for the Premises shall be retroactively adjusted to the commencement of the Renewal Term for the Premises. If such adjustment results in an underpayment of Base Rent by Tenant, Tenant shall pay Landlord the amount of such underpayment within 30 days after the determination thereof. If such adjustment results in an overpayment of Base Rent by Tenant, Landlord shall credit such overpayment against the next installment of Base Rent due under the Lease and, to the extent necessary, any subsequent installments, until the entire amount of such overpayment has been credited against Base Rent.

E. Renewal Amendment. If Tenant is entitled to and properly exercises its Renewal Option, Landlord shall prepare an amendment (the "**Renewal Amendment**") to reflect changes in the Base Rent, Term, Termination Date and other appropriate terms. The Renewal Amendment shall be sent to Tenant within a reasonable time after Landlord's receipt of the Binding Notice or other written agreement by Landlord and Tenant regarding the Prevailing Market rate, and Tenant shall execute and return the Renewal Amendment to Landlord within 15 days after Tenant's receipt of same, but, upon final determination of the Prevailing Market rate applicable during the Renewal Term as described herein, an otherwise valid exercise of the Renewal Option shall be fully effective whether or not the Renewal Amendment is executed.

F. Definition of Prevailing Market. For purposes of this Renewal Option, "**Prevailing Market**" shall mean the arms length fair market annual rental rate per rentable square foot under renewal leases and amendments entered into on or about the date on which the Prevailing Market is being determined hereunder for space comparable to the Premises in the Building and office buildings comparable to the Building in the San Jose, California airport area. The determination of Prevailing Market shall take into account any material economic differences between the terms of this Lease and any comparison lease or amendment, such as rent abatements, construction costs and other concessions and the manner, if any, in which the landlord under any such lease is reimbursed for operating expenses and taxes. The determination of Prevailing Market shall also take into consideration any reasonably anticipated changes in the Prevailing Market rate from the time such Prevailing Market rate is being determined and the time such Prevailing Market rate will become effective under this Lease.

G. Subordination. Notwithstanding anything herein to the contrary, Tenant's Renewal Option is subject and subordinate to the expansion rights (whether such rights are designated as a right of first offer, right of first refusal, expansion option or otherwise) of any tenant of the Building existing on the date hereof.

3. Moving Allowance. Provided Tenant is not in default under the Lease, Tenant shall be entitled to a moving allowance in the amount of up to \$15,000.00 (the "**Moving Allowance**") toward the cost of moving from its existing location into the Premises, including, without limitation, the cost of telephone, data and computer cabling, consulting fees, reprinting stationery on hand, moving Tenant's furniture, equipment and other personal property into the Premises ("**Moving and Relocation Costs**"). Any unused portion of the Moving Allowance shall accrue to the sole benefit of Landlord, it being understood and agreed that Tenant shall not be entitled to receive any credit or abatement in connection therewith. Landlord shall disburse the Moving Allowance, or applicable portion thereof, to Tenant within forty-five (45) days after the later to occur of (i) receipt of invoices from Tenant with respect to Tenant's actual Moving and Relocation Costs, and (ii) the Commencement Date. However, in no event shall Landlord have any obligation to disburse any portion of the Moving Allowance after the date which is three (3) months after the Commencement Date.

EXHIBIT G

PARKING AGREEMENT

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

1. During the initial Term, Tenant agrees to lease from Landlord and Landlord agrees to lease to Tenant a total of 29 unreserved parking spaces and 0 reserved spaces (collectively, the “**Spaces**”), for the use of Tenant and its employees, in the parking facility owned by Landlord that serves the Building (the “**Parking Facility**”), and if the Parking Facility includes a garage, then such Spaces may be in, or on the roof of, such garage. No deductions or allowances shall be made for days when Tenant or any of its employees does not utilize the Parking Facility or for Tenant utilizing less than all of the Spaces. Tenant shall not have the right to lease or otherwise use more than the number of reserved and unreserved Spaces set forth above.
2. During the initial Term, Tenant shall pay Landlord, as Additional Rent in accordance with Section 4 of the Lease, the sum of \$0.00 per month, plus applicable tax thereon, if any, for each unreserved Space leased by Tenant hereunder, and the sum of \$0.00 per month, plus applicable tax thereon, if any, for each reserved Space leased by Tenant hereunder, as such rates may be adjusted from time-to-time to reflect the then current rate for parking in the Parking Facility.
3. Except for particular spaces and areas designated by Landlord or the Operator (as defined in paragraph 10, below) for reserved parking, all parking in the Parking Facility shall be on an unreserved, first-come, first-served basis.
4. Neither Landlord nor its Operator shall not be responsible for money, jewelry, automobiles or other personal property lost in or stolen from the Parking Facility regardless of whether such loss or theft occurs when the Parking Facility is locked or otherwise secured. Except as caused by the negligence or willful misconduct of Landlord and without limiting the terms of the preceding sentence, Landlord shall not be liable for any loss, injury or damage to persons using the Parking Facility or automobiles or other property therein, it being agreed that, to the fullest extent permitted by law, the use of the Spaces shall be at the sole risk of Tenant and its employees. Except as caused by the negligence or willful misconduct of Operator and without limiting the terms of the preceding sentence, Operator shall not be liable for any loss, injury or damage to persons using the Parking Facility or automobiles or other property therein, it being agreed that, to the fullest extent permitted by law, the use of the Spaces shall be at the sole risk of Tenant and its employees.
5. Landlord or its Operator shall have the right from time to time to designate the location of the Spaces and to promulgate reasonable rules and regulations regarding the Parking Facility, the Spaces and the use thereof, including, but not limited to, rules and regulations controlling the flow of traffic to and from various parking areas, the angle and direction of parking and the like. Tenant shall comply with and cause its employees to comply with all such rules and regulations as well as all reasonable additions and amendments thereto.
6. Tenant shall not store or permit its employees to store any automobiles in the Parking Facility without the prior written consent of Landlord. Except for emergency repairs, Tenant and its employees shall not perform any work on any automobiles while located in the Parking Facility or on the Property. If it is necessary for Tenant or its employees to leave an automobile in the Parking Facility overnight, Tenant shall provide Landlord with prior notice thereof designating the license plate number and model of such automobile.
7. Landlord or the Operator shall have the right to temporarily close the Parking Facility or certain areas therein in order to perform necessary repairs, maintenance and improvements to the Parking Facility, provided that Landlord or the Operator shall make commercially reasonable arrangements for alternative access to the Premises if such closure materially and adversely affects such access.
8. Tenant shall not assign or sublease any of the Spaces without the consent of Landlord. Landlord shall have the right to terminate this Parking Agreement with respect to any Spaces that Tenant desires to sublet or assign.

9. Landlord or the Operator may elect to provide parking cards or keys to control access to the Parking Facility. In such event, Landlord or the Operator shall provide Tenant with one card or key for each Space that Tenant is leasing hereunder, provided that Landlord or the Operator shall have the right to require Tenant or its employees to place a deposit on such access cards or keys and to pay a fee for any lost or damaged cards or keys.
10. Landlord hereby reserves the right to enter into a management agreement or lease with another entity for the operation of the Parking Facility ("**Operator**"). In such event, Tenant, upon request of Landlord, shall enter into a parking agreement with the Operator and pay the Operator the monthly charge established hereunder, and Landlord shall have no liability for claims arising through acts or omissions of the Operator unless caused by Landlord's negligence or willful misconduct. It is understood and agreed that the identity of the Operator may change from time to time during the Term. In connection therewith, any parking lease or agreement entered into between Tenant and any Operator shall be freely assignable by such Operator or any successors thereto.

EXHIBIT H

ASBESTOS NOTIFICATION

This Exhibit is attached to and made a part of the Lease by and between **CA-GATEWAY OFFICE LIMITED PARTNERSHIP** (“Landlord”) and **AUDIOCODES, INC.** (“Tenant”) for space in the Building located at 2099 Gateway Place, San Jose, California.

Asbestos-containing materials (“**ACMs**”) were historically commonly used in the construction of commercial buildings across the country. ACMs were commonly used because of their beneficial qualities; ACMs are fire-resistant and provide good noise and temperature insulation.

Some common types of ACMs include surfacing materials (such as spray-on fireproofing, stucco, plaster and textured paint), flooring materials (such as vinyl floor tile and vinyl floor sheeting) and their associated mastics, carpet mastic, thermal system insulation (such as pipe or duct wrap, boiler wrap and cooling tower insulation), roofing materials, drywall, drywall joint tape and drywall joint compound, acoustic ceiling tiles, transite board, base cove and associated mastic, caulking, window glazing and fire doors. These materials are not required under law to be removed from any building (except prior to demolition and certain renovation projects). Moreover, ACMs generally are not thought to present a threat to human health unless they cause a release of asbestos fibers into the air, which does not typically occur unless (1) the ACMs are in a deteriorated condition, or (2) the ACMs have been significantly disturbed (such as through abrasive cleaning, or maintenance or renovation activities).

It is possible that some of the various types of ACMs noted above (or other types) are present at various locations in the Building. Anyone who finds any such materials in the building should assume them to contain asbestos unless those materials are properly tested and determined to be otherwise. In addition, Landlord has identified the presence of certain ACMs in the Building. For information about the specific types and locations of these identified ACMs, please contact the Building manager. The Building manager maintains records of the Building’s asbestos information including any Building asbestos surveys, sampling and abatement reports. This information is maintained as part of Landlord’s asbestos Operations and Maintenance Plan (“**O&M Plan**”).

The O&M Plan is designed to minimize the potential of any harmful asbestos exposure to any person in the building. Because Landlord is not a physician, scientist or industrial hygienist, Landlord has no special knowledge of the health impact of exposure to asbestos. Therefore, Landlord hired an independent environmental consulting firm to prepare the Building’s O&M Plan. The O&M Plan includes a schedule of actions to be taken in order to (1) maintain any building ACMs in good condition, and (2) to prevent any significant disturbance of such ACMs. Appropriate Landlord personnel receive regular periodic training on how to properly administer the O&M Plan.

The O&M Plan describes the risks associated with asbestos exposure and how to prevent such exposure. The O&M Plan describes those risks, in general, as follows: asbestos is not a significant health concern unless asbestos fibers are released and inhaled. If inhaled, asbestos fibers can accumulate in the lungs and, as exposure increases, the risk of disease (such as asbestosis and cancer) increases. However, measures taken to minimize exposure and consequently minimize the accumulation of fibers, can reduce the risk of adverse health effects.

The O&M Plan also describes a number of activities which should be avoided in order to prevent a release of asbestos fibers. In particular, some of the activities which may present a health risk (because those activities may cause an airborne release of asbestos fibers) include moving, drilling, boring or otherwise disturbing ACMs. Consequently, such activities should not be attempted by any person not qualified to handle ACMs. In other words, the approval of Building management must be obtained prior to engaging in any such activities. Please contact the Building manager for more information in this regard. A copy of the written O&M Plan for the Building is located in the Building Management Office and, upon your request, will be made available to tenants to review and copy during regular business hours.

Because of the presence of ACM in the Building, Landlord is also providing the following warning, which is commonly known as a California Proposition 65 warning: **WARNING: This building contains asbestos, a chemical known to the State of California to cause cancer.**

Please contact the Building manager with any questions regarding the contents of this Exhibit H.

EXHIBIT I
FORM OF CONFIDENTIALITY AGREEMENT

_____, 20_

Fill in Tenant [or Transferee] Name

Dear _____:

In connection with the possible interest of AudioCodes, Inc. (“**Sublandlord**”) in securing the consent of _____ (“**Landlord**”) to Sublandlord’s [subletting space or assigning or transferring its rights and obligations] (the “**Transfer**”) pursuant to Section 11 of that certain Office Lease Agreement by and between Sublandlord and Landlord dated as of _____ (as amended, the “**Lease**”) to *Fill in name of Transferee* (the “**Company**”) in the building located at _____ (the “**Building**”), you have agreed to deliver to Landlord certain information which is either non-public, confidential or proprietary in nature (the “**Information**”) relating to the business operations of the Company. In consideration of your furnishing us with the Information, we agree as follows:

1. The Company shall disclose the Information to Landlord so that it may evaluate whether or not to consent to the Transfer. Landlord shall accept and hold such Information in strict confidence in accordance with the provisions of this letter.
2. The Information will be kept strictly confidential and, without your prior written consent, Landlord shall not use the Information for any purpose other than in connection with evaluating the Transfer. Landlord also agrees to transmit the Information only to those individuals who are actively and directly participating in the evaluation of the Company and who have agreed to comply with the terms of this letter.
3. The Information shall not be deemed to include information which falls within any of the following categories:
 - (a) Information which has come within the public domain through no fault or action of Landlord or its representatives;
 - (b) Information which was known to Landlord on a non-confidential basis prior to its disclosure hereunder; or
 - (c) Information which becomes available to Landlord on a non-confidential basis from any third party.
4. Landlord, when requested by you, shall immediately destroy the Information, including all notes, copies, reproductions, summaries, analyses, or extracts thereof, then in its possession. Such return or destruction shall not abrogate Landlord’s continuing obligations under this letter.
5. It is understood that this letter does not constitute an agreement by either party to enter into a lease and does not obligate Landlord or the Company to enter into any further discussions or agreements in connection with the possibility of entering into a lease.
6. The terms of this letter shall inure to the benefit of Landlord, the Company and their successors and assigns.
7. Notwithstanding anything to the contrary contained herein, Landlord shall be entitled to disclose the Information in accordance with the terms of any court order, provided that Landlord provides the Company with prior notice of such disclosure.

8. The terms of this letter shall be governed by and construed in accordance with the laws of the state in which the Building is located.

Please indicate your acceptance of the terms of this letter by signing the enclosed copy of the same and returning it to us at the address indicated on the first page of this letter.

Very truly yours,

LANDLORD:

_____, a(n)

By: _____, a(n)

By: _____, a(n)

By: _____

Name: _____

Title: _____

Acknowledged and Agreed to
this ____ day of _____, 20__

COMPANY: _____

By:
Name: _____
Title: _____

Subsidiaries of AudioCodes, Ltd.

AudioCodes Inc

AudioCodes National Inc.

Ai-Logix Inc

AudioCodes Europe Limited

AudioCodes Brasil Equipamentos de Voz sobre IP Ltda

**CERTIFICATION PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002**

I, Shabtai Adlersberg, certify that:

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

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls.

Date: June 2, 2005

/S/ SHABTAI ADLERSBERG

Shabtai Adlersberg
Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002**

I, Nachum Falek, certify that:

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

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls.

Date: June 2, 2005

/S/ NACHUM FALEK

Nachum Falek
Vice President Finance and
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of AudioCodes Ltd. (the "Company") on Form 20-F for the period ending December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Shabtai Adlersberg, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

Date: June 2, 2005

SHABTAI ADLERSBERG

Shabtai Adlersberg
Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of AudioCodes Ltd. (the "Company") on Form 20-F for the period ending December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Nachum Falek, Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

Date: June 2, 2005

BY: /S/ Nachum Falek

Nachum Falek
Vice President and
Chief Financial Officer

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the following Registration Statements:

1. Registration Statement on Form F-3 (File No. 333-117703),
2. Registration Statement on Form F-3 (File No. 333-123859),
3. Registration Statement on Form S-8 (File No. 333-11894) pertaining to the AudioCodes Ltd. 1999 Key Employee Option Plan (F) and the AudioCodes Ltd. 1999 Key Employee Option Plan, Qualified Stock Option Plan-US Employees (F),
4. Registration Statement on Form S-8 (File No. 333-13268) pertaining to the AudioCodes Ltd. 1999 Key Employee Option Plan (F), as amended, and the AudioCodes Ltd. 1999 Key Employee Option Plan, Qualified Stock Option Plan-US Employees (F),
5. Registration Statement on Form S-8 (File No. 333-105473) pertaining to the AudioCodes Ltd. 1999 Key Employee Option Plan (F) and the AudioCodes Ltd. 1999 Key Employee Option Plan, Qualified Stock Option Plan-US Employees (F) , and
6. Registration Statement on Form S-8 (File No. 333-13378) pertaining to the AudioCodes Ltd. 2001 Employee Stock Purchase Plan Global Non-U.S. and the AudioCodes Ltd. 2001 U.S. Employee Stock Purchase Plan.

of our report dated January 24, 2005 with respect to the consolidated financial statements and schedule of AudioCodes Ltd. included in this Annual Report (Form 20-F) of AudioCodes Ltd.

Tel-Aviv, Israel
June 02, 2005

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