Mellanox Technologies, Ltd.
Form 10-Q
May 08, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period __________ to __________

Commission File No. 001-33299

MELLANOX TECHNOLOGIES, LTD.
(Exact Name of Registrant as Specified in Its Charter)

ISRAEL	**98-0233400**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
HERMON BUILDING, YOKNEAM, ISRAEL	**20692**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code: **+972-4-909-7200**

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 þ No o

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

o Large accelerated filer o Accelerated filer þ Non-accelerated filer

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

The total number of outstanding shares of the registrant s Ordinary Shares, nominal value of NIS 0.0175 per share, as of May 1, 2007, was 29,856,757.

MELLANOX TECHNOLOGIES, LTD.

	Page No.
PART I	
FINANCIAL INFORMATION	
ITEM 1. Condensed Consolidated Financial Statements (Unaudited)	3
Condensed Consolidated Balance Sheets December 31, 2006 and March 31, 2007	3
Condensed Consolidated Statements of Operations Three Months Ended March 31, 2006 and 2007	4
Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2006 and 2007	5
Notes to Condensed Consolidated Financial Statements	6
ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	13
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	19
ITEM 4T. Controls and Procedures	20
PART II	
OTHER INFORMATION	
ITEM 1. Legal Proceedings	20
ITEM 1A. Risk Factors	20
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
ITEM 3. Defaults Upon Senior Securities	34
ITEM 4. Submission of Matters to a Vote of Security Holders	34
ITEM 5. Other Information	34
ITEM 6. Exhibits	34
EXHIBIT 31.1	
EXHIBIT 31.2	
EXHIBIT 32.1	
EXHIBIT 32.2	

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1 *CONDENSED CONSOLIDATED FINANCIAL STATEMENTS*
MELLANOX TECHNOLOGIES, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	December 31, 2006	March 31, 2007
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,570	$ 132,786
Restricted cash	678	622
Accounts receivable, net of allowance for doubtful accounts of $107 and $104 for December 31, 2006, and March 31, 2007, respectively	10,141	8,515
Inventories	4,079	4,337
Prepaid expenses and other	2,470	1,148
Total current assets	37,938	147,408
Property and equipment, net	2,588	2,748
Severance assets	2,284	2,443
Intangible assets, net	167	148
Other long-term assets	124	105
Total assets	$ 43,101	$ 152,852
LIABILITIES, CONVERTIBLE PREFERRED SHARES AND SHAREHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	4,490	4,387
Other accrued liabilities	6,426	7,014
Capital lease obligations, current	420	388
Other liabilities, current	1,156	
Total current liabilities	12,492	11,789
Accrued severance	2,940	3,376
Capital lease obligations, net of current portion	541	437
Other long-term obligations	96	92
Total liabilities	16,069	15,694
Commitments and contingencies		
Mandatorily redeemable convertible preferred shares	55,759	
Convertible preferred shares	36,338	
Shareholders equity (deficit)		
Ordinary shares	32	124
Additional paid-in capital	4,174	203,019

Accumulated deficit	(69,271)	(65,985)
Total shareholders equity (deficit)	(65,065)	137,158
Total liabilities, convertible preferred shares and shareholders equity (deficit)	$ 43,101	$ 152,852

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

Page 3

Table of Contents

MELLANOX TECHNOLOGIES, LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31, 2006	2007
	(In thousands, except per share data)	
Total revenues	$ 8,506	$ 16,855
Cost of revenues	(2,506)	(4,270)
Gross profit	6,000	12,585
Operating expenses:		
Research and development	3,560	5,944
Sales and marketing	1,785	2,791
General and administrative	826	1,357
Total operating expenses	6,171	10,092
Income (loss) from operations	(171)	2,493
Other income, net	134	957
Income (loss) before taxes on income	(37)	3,450
Provision for taxes on income	(54)	(164)
Net income (loss)	$ (91)	$ 3,286
Accretion of Series D mandatorily redeemable convertible preferred shares	(44)	
Net income (loss) attributable to ordinary shareholders	(135)	3,286
Net income (loss) per share attributable to ordinary shareholders basic	$ (0.02)	$ 0.16
Net income (loss) per share attributable to ordinary shareholders diluted	$ (0.02)	$ 0.15
Shares used in computing income (loss) per share attributable to ordinary shareholders:		
Basic	7,652	20,310
Diluted	7,652	22,657

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

Page 4

Table of Contents

MELLANOX TECHNOLOGIES, LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31,	
	2006	2007
	(In thousands of dollars)	
Cash flows from operating activities:		
Net income (loss)	$ (91)	$ 3,286
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	421	350
Share-based compensation expense	47	598
Accrued interest		(15)
Changes in assets and liabilities:		
Accounts receivable, net	1,421	1,626
Inventories	(73)	(258)
Prepaid expenses and other assets	(120)	1,341
Accounts payable	(1,324)	(103)
Accrued liabilities and other payables	113	(131)
Net cash provided by operating activities	394	6,694
Cash flows from investing activities:		
Purchase of severance-related insurance policies	(86)	(159)
Return of restricted cash deposit		71
Purchase of property and equipment	(55)	(491)
Net cash used in investing activities	(141)	(579)
Cash flows from financing activities:		
Principal payments on capital lease obligations	(48)	(136)
Proceeds from initial public offering, net of issuance costs		106,015
Proceeds from exercise of share options		222
Net cash provided by (used in) financing activities	(48)	106,101
Net increase in cash and cash equivalents	205	112,216
Cash and cash equivalents at beginning of period	12,350	20,570
Cash and cash equivalents at end of period	$ 12,555	$ 132,786

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

Table of Contents

MELLANOX TECHNOLOGIES, LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Company

Mellanox Technologies, Ltd., an Israeli company, and its wholly-owned subsidiary, Mellanox Technologies, Inc., a California corporation (collectively referred to as the Company or Mellanox), were incorporated and commenced operations in March 1999. Mellanox is a supplier of semiconductor-based, high-performance interconnect products for computing, storage and communications applications. The principal market for the Company s products is the United States.

Principles of presentation

The condensed consolidated financial statements included in this quarterly report on Form 10-Q have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures contained in this quarterly report comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a quarterly report on Form 10-Q and are adequate to make the information presented not misleading. The condensed consolidated financial statements included herein reflect all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s annual report on Form 10-K dated March 26, 2007. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be anticipated for the entire year ending December 31, 2007 or thereafter.

Reverse share split

On February 1, 2007, the Company effected a 1.75-to-1.0 reverse split of the Company s ordinary shares, mandatorily redeemable convertible preferred shares and convertible preferred shares (the Share Split) pursuant to the filing of the Amended and Restated Articles of Association. All references to shares in the consolidated financial statements and the accompanying notes, including but not limited to the number of shares and per share amounts, unless otherwise noted, have been adjusted to reflect retroactively the Share Split. Previously awarded options and warrants to purchase the Company s ordinary shares have been also retroactively adjusted to reflect the Share Split. On February 1, 2007, the Company also increased its authorized share capital to NIS 2,400,000, divided into a total of 123,570,572 ordinary shares and 13,572,285 preferred shares.

Initial public offering

On February 13, 2007, the Company closed the initial public offering of its ordinary shares. The Company sold 6,900,000 ordinary shares in the offering, which included the underwriters exercise in full of their option to purchase up to 900,000 shares to cover over-allotments, at an offering price of $17.00 per share. Net proceeds generated by the offering, after adjusting for offering costs, totaled approximately $106 million. Immediately prior to the closing of the initial public offering, all of the outstanding preferred shares converted into an aggregate of 15,035,712 ordinary shares of the Company (see also Note 6).

Risks and uncertainties

The Company is subject to all of the risks inherent in a company which operates in the dynamic and competitive semiconductor industry. Significant changes in any of the following areas could have a material adverse impact on the Company s financial position and results of operations: unpredictable volume or timing of customer orders; the sales outlook and purchasing patterns of the Company s customers, based on consumer demands and general economic conditions; loss of one or more of the Company s customers; decreases in the average selling prices of products or increases in the average cost of finished goods; the availability, pricing and timeliness of delivery of components used in the Company s products; reliance on a limited number of subcontractors to manufacture, assemble, package and production test our products; the Company s ability to successfully develop, introduce and sell new or enhanced products in a timely manner; product obsolescence and the Company s ability to manage product transitions; and the timing of announcements or introductions of new products by the Company s competitors.

Table of Contents

Additionally, the Company has a significant presence in Israel, including research and development activities, corporate facilities and sales support operations. Uncertainty surrounding the political, economic and military conditions in Israel may directly impact the Company s financial results.

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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of credit risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents, short-term investments and accounts receivable. The Company s accounts receivable are derived from revenue earned from customers located in North America, Europe and Asia. The Company performs ongoing credit evaluations of its customers financial condition and generally requires no collateral from its customers. The Company maintains an allowance for doubtful accounts receivable based upon the expected collectibility of accounts receivable. The Company reviews its allowance for doubtful accounts quarterly by assessing individual accounts receivable over a specific aging and amount, and all other balances based on historical collection experience and an economic risk assessment. If the Company determines that a specific customer is unable to meet its financial obligations to the Company, the Company provides an allowance for credit losses to reduce the receivable to the amount management believes will be collected.

The following table summarizes the revenues from customers (including original equipment manufacturers) in excess of 10% of the total revenues:

	Three Months Ended March 31,	
	2006	**2007**
Cisco	9%	26%
Voltaire	11%	20%
Hewlett-Packard	7%	16%
Network Appliance	12%	7%
Linux Networx	10%	1%

At March 31, 2007, Voltaire, Jabil Circuit and Mentor Media accounted for 29%, 26% and 14% of total accounts receivable, respectively.

Revenue recognition

The Company accounts for its revenue under the provisions of Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements.* Under SAB No. 104, revenues from sales of products are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is reasonably assured. The Company s standard arrangement with its customers includes freight-on-board shipping point, 30-day payment terms, no right of return and no customer acceptance provisions. The Company generally relies upon a purchase order as persuasive evidence of an arrangement.

Probability of collection is assessed on a customer-by-customer basis. Customers are subject to a credit review process that evaluates the customers financial position and ultimately their ability to pay. If it is determined at the outset of an arrangement that collection is not probable, no product is shipped and no revenue is recognized unless cash is received in advance.

In accordance with SFAS No. 5, *Accounting for Contingencies,* the Company provides for potential warranty liability costs in the same period as the related revenues are recorded. This estimate is based on past experience of historical warranty claims and other known factors. The Company s warranty period for its products is generally one year. In cases where the customer wishes to extend the warranty for more than one year, the Company charges an additional fee. This amount is recorded as deferred revenue and recognized over the period that the extended warranty is provided and the related performance obligation is satisfied. To date, amounts received relating to extended warranty revenue have not been significant.

In accordance with Emerging Issuers Task Force (EITF) Issue No. 00-10, *Accounting for Shipping and Handling Fees and Costs,* costs incurred for shipping and handling expenses to customers are recorded as cost of revenues. To the extent these amounts are billed to the customer in a sales transaction, the Company records the shipping and handling fees as revenue.

Product warranty

The Company typically offers a one-year limited warranty period for its products. The Company accrues for estimated returns of defective products at the time revenue is recognized based on prior historical activity. The determination of these accruals requires the Company to make estimates of the frequency and extent of warranty activity and estimated future costs to either replace or repair the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to record additional cost of revenues may be required in future periods. Changes in the Company s liability for product warranty during the three months ended March 31, 2006 and 2007, are as follows:

	Three Months Ended March 31,	
	2006	**2007**
	(In thousands of dollars)	
Balance, beginning of the period	$ 517	$ 528
New warranties issued during the period	62	6
Settlements during the period	(76)	(35)
Balance, end of the period	$ 503	$ 499

Net income (loss) per share attributable to ordinary shareholders

Basic and diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of ordinary shares outstanding during the period. The calculation of diluted net income (loss) per share excludes potential ordinary shares if the effect is antidilutive. Potential ordinary shares are comprised of ordinary shares subject to repurchase rights, incremental ordinary shares issuable upon the exercise of share options or warrants and shares issuable upon conversion of convertible preferred shares.

In accordance with Emerging Issue Task Force (EITF) Issue 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128,* earnings are allocated between the common shareholders and other security holders based on their respective rights to receive dividends. When determining basic earnings per share under EITF 03-6, undistributed earnings for a period

Table of Contents

are allocated to a participating security based on the contractual participation rights of the security to share in those earnings as if all of the earnings for the period had been distributed. The form of such participation does not have to be a dividend. Any form of participation in undistributed earnings would constitute participation by that security, regardless of whether the payment to the security holder was referred to as a dividend.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated:

	Three Months Ended March 31,	
	2006	**2007**
	(In thousands, except per share data)	
Net income (loss)	$ (91)	$ 3,286
Accretion of Series D mandatorily redeemable convertible preferred shares	(44)	
Net income (loss) attributable to ordinary shareholders	(135)	3,286
Basic and diluted shares:		
Weighted average ordinary shares outstanding	7,655	20,313
Weighted average unvested ordinary shares subject to repurchase	(3)	(3)
Shares used to compute basic net income (loss) per share	7,652	20,310
Effect of dilutive securities ordinary share options		2,347
Shares used to compute diluted net income (loss) per share	7,652	22,657
Net income (loss) per share attributable to ordinary shareholders basic	$ (0.02)	$ 0.16
Net income (loss) per share attributable to ordinary shareholders diluted	$ (0.02)	$ 0.15

The following table sets forth potential ordinary shares that are not included in the diluted net income (loss) per share attributable to ordinary shareholders above because to do so would be antidilutive for the periods indicated:

	March 31,	
	2006	**2007**
	(In thousands)	
Convertible preferred shares (Series A, B and C) upon conversion to ordinary shares	6,799	0
Convertible preferred shares (Series D) upon conversion to ordinary shares	4,838	0
Warrants to purchase ordinary shares	725	0
Options to purchase ordinary shares	18	1,086
	12,380	1,086

Segment reporting

Statement of Financial Accounting Standards No. 131, *Disclosure about Segments of an Enterprise and Related Information,* or SFAS No. 131, requires that companies report separately in their financial statements certain financial and descriptive information about operating segments profit or loss, certain specific revenue and expense items and segment assets. Additionally, companies are required to report information about the revenues derived from their products and service groups, about geographic areas in which they earn revenues and hold assets and about major customers. The Company has one reportable segment: the development, manufacturing, marketing and sales of InfiniBand semiconductor products.

Recent accounting pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition and measurement method of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The impact of the adoption of FIN 48 was not material on our financial statements (see also Note 5).

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements,* or SFAS No. 157, which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for the Company as of January 1, 2008. We expect that the impact, if any, of the adoption of SFAS No. 157 will not be material on our financial statements.

Table of Contents

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* or SFAS No. 159, which permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This election is irrevocable. SFAS No. 159 will be effective for us on January 1, 2008. We are currently assessing the potential impact that the adoption of SFAS No. 159 will have on our financial statements.

NOTE 2 BALANCE SHEET COMPONENTS:

	December 31, 2006	March 31, 2007
	(In thousands of dollars)	
Cash and cash equivalents:		
Cash	$ 8,212	$ 8,906
Money market funds	2,585	2,324
Repurchase agreements	9,773	121,556
	$ 20,570	$ 132,786
Accounts receivable, net:		
Accounts receivable	$ 10,248	$ 8,619
Less: Allowance for doubtful accounts	(107)	(104)
	$ 10,141	$ 8,515
Inventories:		
Raw materials	$ 692	$ 493
Work-in-process	1,492	588
Finished goods	1,895	3,256
	$ 4,079	$ 4,337
Prepaid expense and other:		
Prepaid expenses	$ 223	$ 554
Deferred public offering costs	1,827	
Deferred tax assets, current	288	288
Other	132	306
	$ 2,470	$ 1,148
Property and equipment, net:		
Computer equipment and software	$ 16,580	$ 16,995
Furniture and fixtures	793	803
Leasehold improvements	543	609
	17,916	18,407

Less: Accumulated depreciation and amortization	(15,328)	(15,659)
	$ 2,588	$ 2,748
Other accrued liabilities:		
Payroll and related expenses	$ 2,618	$ 3,278
Professional services	1,927	2,022
Royalties	526	366
Warranty	528	499
Sales commissions	519	468
Other	308	381
	$ 6,426	$ 7,014
Other long-term obligations:		
Federal income tax payable	64	64
Other	32	28
	$ 96	$ 92

NOTE 3 COMMITMENTS AND CONTINGENCIES:

Leases

As of March 31, 2007, future minimum lease payments under non-cancelable operating and capital leases, and future minimum sublease rental receipts under non-cancelable operating leases are as follows:

Year Ended December 31,	Capital Leases	Operating Leases	Sublease Income
	(In thousands of dollars)		
2007	$ 280	$ 3,653	$ 37
2008	396	1,913	0
2009	150	1,272	0
2010	0	773	0
2011	0	773	0
Total minimum lease payments and sublease income	$ 826	$ 8,384	$ 37
Less: Amount representing interest	(1)		
Present value of capital lease obligations	825		
Less: Current portion	(388)		
Long-term portion of capital lease obligations	$ 437		

Purchase commitments

As of March 31, 2007, the Company had no non-cancelable purchase commitments with suppliers beyond one year.

Contingencies

The Company is not currently subject to any material legal proceedings. The Company may, from time to time, become a party to various legal proceedings arising in the ordinary course of business. The Company may also be indirectly affected by administrative or court proceedings or actions in which the Company is not involved but which have general applicability to the semiconductor industry.

NOTE 4 SHARE INCENTIVE PLANS:

In 1999, the Company s board of directors approved share option plans for U.S. and Israeli optionees (together, the 1999 Plan), pursuant to which options could be granted to directors, employees and consultants of the Company. In 2003, the Company s board of directors approved an additional share option plan for Israeli optionees (the 2003 Plan and together with the 1999 Plan, the Plans), pursuant to which options may be granted to directors, employees and consultants of the Company.

Options granted under the Plans were either incentive share options or nonqualified share options. Incentive share options (ISOs) may be granted only to Company employees (including officers and directors who are also employees). Nonqualified share options (NSOs) were allowed to be granted to Company employees and consultants. In 2001, NSO options on an additional 58,285 ordinary shares were approved by the Company s board of directors for certain service providers to the Company.

Each option granted under the Plans is exercisable until the earlier of ten years from the date of the grant of the option or the expiration date of the respective option. The exercise price of the options granted under the Plans were not allowed to be less than the nominal value of the shares for which such options are exercised. The options generally vested over a period of four years. Any options which are forfeited or not exercised before expiration became available for future grants under the Plans.

Share options granted to U.S. employees under the 1999 Plan included an early exercise option, pursuant to which unvested options can be exercised and the related shares received are subject to a repurchase right held by the

Company. The related shares are considered issued and outstanding for accounting purposes but are not deemed exercised until the Company s repurchase right expires. Accordingly, the Company accounts for the cash received in consideration for the early exercised options as a liability. The purchase price of the early exercised shares subject to the Company s repurchase right is equal to the original exercise price of the share options. The Company s repurchase right lapses as the early exercised shares vest. As of March 31, 2006 and 2007, 5,090 and 2,629 ordinary shares, respectively, were subject to repurchase.

Our 2006 Global Share Incentive Plan (the Global Plan) was adopted by our board of directors in October 2006 and approved by our shareholders in December 2006. The Global Plan replaced the Plans and became effective on February 6, 2007. We have authorized for issuance under our Global Plan an aggregate of 3,428,571 ordinary shares, plus the number of ordinary shares available for issuance under the Prior Plans that were not subject to outstanding options, as of the effective date of the Global Plan. In addition, the share reserve under the Global Plan will be increased by the number of ordinary shares issuable pursuant to options outstanding under the Plans that would have otherwise reverted to the Plans because they expired, were canceled or were otherwise terminated without being exercised, following the date that our Global Plan became effective. In addition, the number of ordinary shares reserved for issuance under our Global Plan will increase automatically on the first day of each fiscal year, beginning in 2008, by a number of

Table of Contents

ordinary shares equal to the least of: (i) 2% of ordinary shares outstanding on a fully diluted basis on such date, (ii) 685,714 ordinary shares or (iii) a smaller number determined by our board of directors. In any event, the maximum aggregate number of ordinary shares that may be issued or transferred under the Global Plan during the term of the Global Plan may in no event exceed 15,474,018 ordinary shares.

Our Employee Share Purchase Plan, or ESPP, was adopted by our board of directors in November 2006 and approved by our shareholders in December 2006, and became effective immediately prior to our initial public offering on February 7, 2007. The ESPP is designed to allow our eligible employees to purchase our ordinary shares, at semi-annual intervals, with their accumulated payroll deductions. 571,428 shares have been initially reserved for issuance pursuant to purchase rights under the ESPP. A participant may contribute up to 15% of his or her compensation through payroll deductions, and the accumulated deductions will be applied to the purchase of shares on the purchase date, which is the last trading day of the offering period. The purchase price per share will be equal to 85% of the fair market value per share on the start date of the offering period in which the participant is enrolled or, if lower, 85% of the fair market value per share on the purchase date. In addition, the number of ordinary shares reserved under our ESPP will increase automatically on the first day of each fiscal year during the term, beginning in 2008, by a number of ordinary shares equal to the least of (i) 0.5% of the total number of ordinary shares outstanding on a fully diluted basis on the date of the increase, (ii) 171,428 shares, or (iii) a smaller number of shares as determined by our board of directors. In any event, the maximum aggregate number of ordinary shares that may be issued over the term of the ESPP may in no event exceed 2,114,285 shares. In addition, no participant in our ESPP may be issued or transferred more than $25,000 worth of ordinary shares pursuant to purchase rights under the ESPP per calendar year.

	Options Outstanding		
	Shares Available for Grant	**Number of Shares**	**Weighted Average Exercise Price**
Outstanding at December 31, 2006	125,473	5,166,815	$ 4.19
Options granted	(163,611)	163,611	$ 17.67
Options exercised		(42,263)	$ 5.25
Options canceled	7,365	(7,365)	$ 8.21
Approved addition to employee option pool	3,428,571		$ 17.00
Outstanding at March 31, 2007	3,397,798	5,280,798	$ 4.59

The weighted average fair value of options granted was approximately $5.72 and $11.33 for the three months ended March 31, 2006 and 2007, respectively.

Share-based compensation

The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Accounting for Stock Based Compensation,* or SFAS No. 123(R) as of January 1, 2006 using the prospective transition method. Under this method, SFAS No. 123(R) is applied to new awards and to awards modified, repurchased or cancelled after the adoption date of January 1, 2006. Compensation cost that was previously recorded under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees"*, or APB No. 25, for employee awards outstanding at the adoption date, such as unvested options, will continue to be recognized as the options vest. Compensation cost for non-employees that was recorded under FAS No. 123 will also continue to be recognized as the options vest. Accordingly, from January 1, 2006 onward, share-based compensation expense includes compensation cost related to estimated fair values of awards granted after the adoption of SFAS No. 123(R), compensation costs related to unvested awards at the date of adoption based on the intrinsic values as previously recorded under APB No. 25, and compensation costs for share-based awards granted to non-employees prior and subsequent to January 1, 2006 recorded under FAS No. 123.

The fair value of options granted after January 1, 2006 is estimated on the grant date using the Black-Scholes option valuation model. This valuation model requires the Company to make assumptions and judgments about the variables used in the calculation including the expected term the options granted are expected to be outstanding, the volatility of the Company s ordinary shares, an assumed risk-free interest rate and the estimated forfeitures of unvested share options. To the extent actual forfeitures differ from the estimates, the difference will be recorded as an adjustment in the period estimates are revised. No compensation cost is recorded for options that do not vest. Because the Company s shares were not publicly traded prior to February 8, 2007, volatility is based on an average of the historical volatilities of the Company s peer group in the industry in which it does business. The expected term is calculated using the simplified method described in SEC Staff Accounting Bulletin (SAB) No. 107. The risk-free rate is based on the five-year Treasury bond yield as of the last day of the quarter. Expected forfeitures are based on the Company s historical experience.

Table of Contents

The following assumptions were used to value share options granted in connection with the Company s share incentive plans for the three months ended March 31, 2007: volatility of 65%, an average risk free rate of 4.55%, an expected term of 6.25 years, a dividend rate of zero and an estimated annual forfeiture rate of 9.43%.

For the three months ended March 31, 2006, the following assumptions were used to value share option grants: volatility of 89%, an average risk free rate of 4.50%, an expected term of 6.25 years, a dividend rate of zero and an estimated annual forfeiture rate of 7.00%.

For share options granted since January 1, 2006, the Company estimates the fair value of the options as of the date of grant using the Black-Scholes valuation model and applies the straight-line method to attribute share-based compensation expense. For the three months ended March 31, 2007, the Company recorded share-based compensation expense for employees and non-employees totaling approximately $598,000 compared to approximately $47,000 for the three months ended March 31, 2006.

The following table summarizes the distribution of total share-based compensation expense in the Consolidated Statements of Operations:

	Three months ended March 31,	
	2006	2007
	(In thousands of dollars)	
Cost of goods sold	$ 0	$ 15
Research and development	4	275
Sales and marketing	39	211
General and administrative	4	97
Total share-based compensation expense	$ 47	$ 598

NOTE 5 INCOME TAXES:

Income taxes are accounted for using an asset and liability approach in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes,* which requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company s financial statements or tax returns. The measurement of current and deferred tax liabilities and assets are based on the provisions of enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are provided if, based upon the weight of available evidence, it is considered more likely than not that some or all of the deferred tax assets will not be realized.

Effective January 1, 2007, we adopted the provisions of FASB Financial Accounting Standards Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* or FIN 48. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes.

As of January 1, 2007, our unrecognized tax benefits (tax contingencies) totaled approximately $133,000. The adoption of FIN 48 resulted in no change to the reserve for tax contingencies that existed at January 1, 2007. As such, there is no change recorded to beginning retained earnings as a result of the adoption.

It is the Company s policy to classify accrued interest and penalties as part of the unrecognized tax benefits (tax contingencies) and record the expense in the provision for income taxes. As of January 1, 2007 the amount of accrued interest and penalties totaled $25,000. For unrecognized tax benefits that exist at March 31, 2007, the Company does not anticipate any significant changes within the next twelve months. As of March 31, 2007, calendar years 2003 through 2006 are open and subject to potential examination in one or more jurisdictions. The Company is not currently under federal, state or foreign income tax examination.

NOTE 6 PREFERRED SHARES

On February 13, 2007, immediately prior to the closing of our initial public offering, all previously outstanding preferred shares automatically converted into an aggregate of 15,035,712 ordinary shares. The following table provides the amounts reclassified to ordinary shares and additional paid-in capital based on the recorded balances of the preferred shares at the date of the automatic conversion (in thousands of dollars):

	Preferred shares		Ordinary shares		Additional paid-in capital	
	Before	After	Before	After	Before	After
Series A Preferred	$ 7,600			$ 18		7,582
Series B Preferred	25,737			10		25,727
Series C Preferred	3,001			1		3,000
Series D Preferred	55,759			34		55,725
Total	$ 92,097			$ 63		$ 92,034

Table of Contents

ITEM 2 *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The following discussion and analysis of our financial condition as of March 31, 2007 and results of operations for the three months ended March 31, 2007 and March 31, 2006 should be read together with our financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under Part II, Item 1A. Risk Factors and elsewhere in this report. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. All forward-looking statements included in this report are based on information available to us on the date of this report, and we assume no obligation to update any forward-looking statements contained in this report. Quarterly financial results may not be indicative of the financial results of future periods.

Overview

General

We are a leading supplier of semiconductor-based, high-performance interconnect products that facilitate data transmission between servers, communications infrastructure equipment and storage systems. Our products are an integral part of a total solution focused on computing, storage and communication applications used in enterprise data center, high-performance computing and embedded systems. We operate in one reportable segment: the development, manufacturing, marketing and sales of InfiniBand semiconductor products.

We are a fabless semiconductor company that provides high-performance interconnect products based on semiconductor integrated circuits, or ICs. We design, develop and market adapter and switch ICs, both of which are silicon devices that provide high performance connectivity. We also offer adapter cards that incorporate our ICs. Growth in our target markets is being driven by the need to improve the efficiency and performance of clustered systems, as well as the need to significantly reduce the total cost of ownership. In addition, we believe that demand for our products will largely depend upon the magnitude and timing of capital spending by end users.

We outsource our manufacturing, assembly, packaging and production test functions, which enables us to focus on the design, development, sales and marketing of our products. As a result, our business has relatively low capital requirements. However, our ability to bring new products to market, fulfill customer orders and achieve long-term growth depends on our ability to maintain sufficient technical personnel and obtain sufficient external subcontractor capacity.

We have experienced rapid growth in our total revenues in each of the last three years. Our revenues increased from $20.3 million to $42.1 million to $48.5 million for the years ended December 31, 2004, 2005 and 2006, respectively. In order to continue to increase our revenues, we must continue to achieve design wins over other InfiniBand providers and providers of competing interconnect technologies. We consider a design win to occur when an OEM or contract manufacturer notifies us that it has selected our products to be incorporated into a product or system under development. Because the life cycles for our customers products can last for several years if these products have successful commercial introductions, we expect to continue to generate revenues over an extended period of time for each successful design win.

It is difficult for us to forecast the demand for our products, in part because of the highly complex supply chain between us and the end-user markets that incorporate our products. Demand for new features changes rapidly. Due to our lengthy product development cycle, it is critical for us to anticipate changes in demand for our various product features and the applications they serve to allow sufficient time for product design. Our failure to accurately forecast demand can lead to product shortages that can impede production by our customers and harm our relationship with these customers. Conversely, our failure to forecast declining demand or shifts in product mix can result in excess or obsolete inventory.

Revenues. We derive revenues from sales of our ICs and cards. To date, we have derived a substantial portion of our revenues from a relatively small number of customers. Revenues were approximately $16.9 million for the three months ended March 31, 2007 compared to approximately $8.5 million for the three months ended March 31, 2006, representing an increase of 98%. Total sales to customers representing more than 10% of revenues accounted for 33%

and 62% of our total revenues for the three months ended March 31, 2006 and 2007, respectively. The loss of one or more of our principal customers or the reduction or deferral of purchases of our products by one of these customers could cause our revenues to decline materially if we are unable to increase our revenues from other customers.

Table of Contents

Cost of revenues and gross profit. The cost of revenues consists primarily of the cost of silicon wafers purchased from our foundry supplier, Taiwan Semiconductor Manufacturing Company, or TSMC, costs associated with the assembly, packaging and production testing of our products by Advanced Semiconductor Engineering, or ASE, outside processing costs associated with the manufacture of our HCA cards by Flextronics, royalties due to third parties, including the Office of the Chief Scientist of Israel s Ministry of Industry, Trade and Labor, or the OCS, the Binational Industrial Research and Development (BIRD) Foundation and a third-party licensor, warranty costs, excess and obsolete inventory costs and costs of personnel associated with production management and quality assurance. In addition, after we purchase wafers from our foundries, we also have the yield risk related to manufacturing these wafers into semiconductor devices. Manufacturing yield is the percentage of acceptable product resulting from the manufacturing process, as identified when the product is tested as a finished IC. If our manufacturing yields decrease, our cost per unit increases, which could have a significant adverse impact on our cost of revenues. We do not have long-term pricing agreements with TSMC and ASE. Accordingly, our costs are subject to price fluctuations based on the cyclical demand for semiconductors.

We purchase our inventory pursuant to standard purchase orders. We estimate that lead times for delivery of our finished semiconductors from our foundry supplier and assembly, packaging and production testing subcontractor are approximately three to four months and that lead times for delivery from our HCA card manufacturing subcontractors are approximately eight to ten weeks. We build inventory based on forecasts of customer orders rather than the actual orders themselves. In addition, as customers are increasingly seeking opportunities to reduce their lead times, we may be required to increase our inventory to meet customer demand.

We expect our cost of revenues to increase over time as a result of the expected increase in our sales volume. Generally, our cost of revenues as a percentage of sales revenues has decreased over time, primarily due to manufacturing cost reductions, economies of scale related to higher unit volumes and our decision to discontinue sales of our lower margin switch systems products in 2005. This trend may not continue in the future, and will depend on overall customer demand for our products, our product mix, competitive product offerings and related pricing and our ability to reduce manufacturing costs.

Operational expenses

Research and development expenses. Our research and development expenses consist primarily of salaries and associated costs for employees engaged in research and development, costs associated with computer aided design software tools, depreciation expense and tape out costs. Tape out costs are expenses related to the manufacture of new products, including charges for mask sets, prototype wafers, mask set revisions and testing incurred before releasing new products. We anticipate these expenses will increase in future periods based on an increase in personnel to support our product development activities and the introduction of new products. We anticipate that our research and development expenses may fluctuate over the course of a year based on the timing of our product tape outs.

We received grants from the OCS for several projects. Under the terms of these grants, if products developed from an OCS-funded project generate revenue, we are required to pay a royalty of 4% of the net sales as soon as we begin to sell such products until 120% of the dollar value of the grant plus interest at LIBOR is repaid. All of the grants we have received from the OCS have resulted in IC products sold by us. In 2004 and 2005, we received an aggregate of $1.3 million and $43,000, respectively, of approved grants in support of some of our research and development programs. We received no grants from the OCS during the year ended December 31, 2006 or the three months ended March 31, 2007. The continued repayment of OCS grants is contingent on future sales of products developed with the support of such grants, and we have no obligation to refund these grants if future sales are not generated. All reported research and development expenses are net of OCS and other government grants.

The terms of OCS grants generally prohibit the manufacture of products developed with OCS funding outside of Israel without the prior consent of the OCS. The OCS has approved the manufacture outside of Israel of our IC products, subject to an undertaking by us to pay the OCS royalties on the sales of our OCS-supported products until such time as the total royalties paid equal 120% of the amount of OCS grants.

Under applicable Israeli law, OCS consent is also required to transfer technologies developed with OCS funding to third parties in Israel. Transfer of OCS-funded technologies outside of Israel is permitted with the approval of the OCS and in accordance with the restrictions and payment obligations set forth under Israeli law. Israeli law further specifies that both the transfer of know-how as well as the transfer of intellectual property rights in such know-how are subject to the same restrictions. These restrictions do not apply to exports of products from Israel or the sale of products developed with these technologies. We do not anticipate the need to transfer any of our intellectual property rights outside of Israel at this time.

Sales and marketing expenses. Sales and marketing expenses consist primarily of salaries and associated costs for employees engaged in sales, marketing and customer support, commission payments to external, third party sales representatives, sales-related legal costs for contract reviews, and charges for trade shows, promotions and travel. We expect these expenses will increase in absolute dollars in future periods based on an increase in sales and marketing personnel and increased commission payments on higher sales volumes.

General and administrative expenses. General and administrative expenses consist primarily of salaries and associated costs for employees engaged in finance, human resources and administrative activities and charges for accounting and corporate legal fees. We expect these expenses will increase in absolute dollars in future periods based on an increase in personnel to meet the requirements associated with our anticipated growth and being a public company.

Taxes on Income

Our operations in Israel have been granted Approved Enterprise status by the Investment Center of the Israeli Ministry of Industry, Trade and Labor, which makes us eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959. Under the terms of the Approved Enterprise program, income that is attributable to our operations in Yokneam, Israel will be exempt from income tax for a period of ten years commencing when we first generate taxable income (after setting off our losses from prior years). Income that is attributable to our operations in Tel Aviv, Israel will be exempt from income tax for a period of two years commencing when we first generate taxable income (after setting off our losses from prior years), and will be subject to a reduced income tax rate (generally 10-25%, depending on the percentage of foreign investment in our company) for the following five to eight years.

Income that is attributable to financing activities, such as the initial public offering we completed in the first quarter of 2007, is generally considered passive income for tax purposes in Israel, and is not eligible for the Approved Enterprise reduced tax rates. Passive income will generally be taxable at the regular corporate tax rate.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

We believe that the assumptions and estimates associated with revenue recognition, allowance for doubtful accounts, inventory valuation, warranty provision, income taxes and share-based compensation have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. For further information on all of our significant accounting policies, please see Note 1 of the accompanying notes to our consolidated financial statements.

We believe there have been no significant changes in our critical accounting policies as compared to what was previously disclosed in our Form 10-K, filed with the Securities and Exchange Commission on March 26, 2007.

Table of Contents

Results of Operations

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

	Three Months Ended March 31,	
	2006	**2007**
Total Revenues	100%	100%
Cost of revenues	(29)	(25)
Gross profit	71	75
Operating expenses:		
Research and development	42	35
Sales and marketing	21	17
General and administrative	10	8
Total operating expenses	73	60
Income (loss) from operations	(2)	15
Other income, net	2	5
Provision for taxes on income	(1)	(1)
Net income (loss)	(1)	19

Comparison of the Three Months Ended March 31, 2007 to the Three Months Ended March 31, 2006

Revenues. Revenues were approximately $16.9 million for the three months ended March 31, 2007 compared to approximately $8.5 million for the three months ended March 31, 2006, representing an increase of 98%. This increase in revenues resulted from increased unit sales of approximately 105% offset by a decrease in average sales prices of 3%. The increase in unit sales was primarily a result of increased purchases by Cisco Systems, which accounted for 26% of our revenues for the three months ended March 31, 2007 compared to 9% of our revenues in the three months ended March 31, 2006. Current quarter revenues are not necessarily indicative of the results to be anticipated for the entire year ending December 31, 2007 or thereafter.

Gross Profit and Margin. Gross profit was approximately $12.6 million for the three months ended March 31, 2007 compared to $6.0 million for the three months ended March 31, 2006, representing an increase of 110%. As a percentage of revenues, gross margin increased to 75% in the three months ended March 31, 2007 from 71% in the three months ended March 31, 2006. This increase in gross margin was due primarily to a reduction in production costs associated with outsourced labor, raw materials and volume discounts. In addition, part of the gross margin improvement was due to increased sales of next generation products for which we receive higher margins.

Research and Development. Research and development expenses were approximately $5.9 million in the three months ended March 31, 2007 compared to approximately $3.6 million in the three months ended March 31, 2006, representing an increase of 67%. The increase consisted of approximately $1.0 million of tapeout costs associated with our new ConnectX product introduction, higher salary related expenses of $929,000 associated with increased headcount, an increase in share based compensation of $271,000 and higher depreciation and amortization expenses of approximately $75,000.

Sales and Marketing. Sales and marketing expenses were approximately $2.8 million for the three months ended March 31, 2007 compared to approximately $1.8 million for the three months ended March 31, 2006, representing an approximate increase of 56%. The increase was primarily attributable to higher salary related expenses of $533,000 associated with increased headcount, an increase in share based compensation of $172,000, an increase in expensed equipment of $118,000 for customer demonstrations and higher tradeshow and marketing expenses of approximately $98,000.

General and Administrative. General and administrative expenses were approximately $1.4 million for the three months ended March 31, 2007 compared to approximately $0.8 million for the three months ended March 31, 2006, representing an increase of 64%. The increase was primarily due to higher legal and accounting fees of approximately $215,000, an increase in facilities related expenses of $124,000, higher salary related expenses of $108,000 associated with increased headcount, an increase in share based compensation of $92,000 and higher travel related costs of $59,000.

Other Income, net. Other income, net consists of interest earned on cash and cash equivalents and foreign currency exchange gains and losses. Other income, net was approximately $957,000 for the three months ended March 31, 2007 compared to approximately $134,000 for the three months ended March 31, 2006. The increase consisted of approximately $945,000 of higher interest income resulting from the availability of the net proceeds of our initial public offering completed in the first quarter of 2007, offset by foreign currency exchange losses of approximately $107,000.

Provision for Taxes on Income. Provision for taxes on income was approximately $164,000 for the three months ended March 31, 2007 compared to approximately $54,000 for the three months ended March 31, 2006. The increase was related to higher income attributable to Mellanox Technologies, Inc., our wholly-owned U.S. subsidiary.

Liquidity and Capital Resources

Since our inception until our initial public offering in February 2007, we have financed our operations primarily through private placements of our convertible preferred shares totaling approximately $89.3 million. We incurred net losses from operations since inception until the second quarter of 2005 and had an accumulated deficit of approximately $66.0 million as of March 31, 2007. As of March 31, 2007, our principal source of liquidity consisted of cash and cash equivalents of approximately $132.8 million. In August 2005, we entered into an agreement with a financial institution to provide us with a line of credit of up to approximately $5.0 million for general working capital requirements. As of March 31, 2007, we had not drawn down on this line of credit.

As of December 31, 2006, we were required to make total remaining payments of approximately $1.2 million to Vitesse Semiconductor Corporation pursuant to a license agreement dated December 16, 2002. This agreement terminated on December 31, 2006, and the $1.2 million was paid by January 31, 2007.

On February 13, 2007, we closed the initial public offering of our ordinary shares. We sold 6,900,000 ordinary shares in the offering, which number of shares included the underwriters exercise in full of their option to purchase up to 900,000 shares to cover over-allotments, at an offering price of $17.00 per share. Net proceeds generated by the offering, after adjusting for offering costs, totaled approximately $106 million. We expect these proceeds, in addition to our cash flows from operating activities, to be sufficient to fund our operations over the next 12 months after taking into account expected increases in research and development expenses, including tape out costs, sales and marketing expenses, general and administrative expenses, primarily for increased headcount, and capital expenditures to support our infrastructure and growth.

During the three months ended March 31, 2007, we incurred costs of approximately $1 million for the tapeout of our new ConnectX semiconductor product. These additional costs were paid in full during the first quarter of 2007.

Table of Contents

Operating Activities

Net cash generated by our operating activities amounted to approximately $6.7 million in the three months ended March 31, 2007. Net cash generated by operating activities was primarily attributable to net income of approximately $3.3 million, a decrease in accounts receivable of approximately $1.6 million due to an increase in the percentage of sales transactions invoiced earlier in the quarter, and a decrease in prepaid expenses and other assets of approximately $1.4 million due to the reclass of deferred equity offering costs against the proceeds of our initial public offering.

Net cash generated by operating activities in the three months ended March 31, 2006 was approximately $394,000. Net cash generated by operating activities was primarily attributable to a decrease in accounts receivable of approximately $1.4 million, a decrease in accounts payable of $1.3 million, non-cash charges of approximately $0.4 million for depreciation and amortization and net losses of approximately $0.1 million.

Investing Activities

Net cash used in investment activities amounted to approximately $0.6 million in the three months ended March 31, 2007 and approximately $0.1 million in the three months ended March 31, 2006. Net cash used in investment activities was primarily attributable to purchases of property and equipment and severance-related insurance policies.

Financing Activities

Our financing activities generated approximately $106 million in the three months ended March 31, 2007, due primarily to our initial public offering. Net cash used in financing activities amounted to $48,000 in the three months ended March 31, 2006, due to principal payments on capital lease obligations.

Contractual Obligations

The following table summarizes our contractual obligations at March 31, 2007 and the effect those obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period			
Contractual Obligations:	**Total**	**Less Than 1 Year**	**1-3 Years**	**Beyond 3 Years**
		(In thousands of dollars)		
Commitments under capital lease	$ 825	$ 388	$ 437	$
Non-cancelable operating lease commitments	8,384	3,834	3,197	1,353
Purchase commitments	4,053	4,053		
Total	$ 13,262	$ 8,275	$ 3,634	$ 1,353

For purposes of this table, purchase obligations for the purchase of goods or services are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Our purchase orders are based on our current manufacturing needs and are fulfilled by our vendors within short time horizons. In addition, we have purchase orders that represent authorizations to purchase rather than binding agreements. We do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements.

Recent Accounting Standards

In June 2006, the FASB issued Financial Accounting Standards Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition and measurement method of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The impact of the adoption of FIN 48 was not material on our financial statements (see also Note 5).

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements,* or SFAS No. 157, which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for the company as of January 1, 2008. We expect that the impact, if any, of the adoption of SFAS No. 157 will not be material on our financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* or SFAS No. 159, which permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This election is irrevocable. SFAS No. 159 will be effective for us on January 1, 2008. We are currently assessing the potential impact that the adoption of SFAS No. 159 will have on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss related to changes in market prices of financial instruments that may adversely impact our consolidated financial position, results of operations or cash flows.

Interest rate fluctuation risk

We do not have any long-term borrowings. Our investments consist of cash and cash equivalents, short-term deposits and interest bearing investments in marketable securities with maturities of one year or less, consisting of commercial paper, government and non-government debt securities. The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to a fluctuation in interest rates, which may affect our interest income and the fair market value of our investments. Due to the short term nature of our investment portfolio, we do not believe an immediate 10% increase in interest rates would have a material effect on the fair market value of our portfolio, and therefore we do not expect our operating results or cash flows to be materially affected to any degree by a sudden change in market interest rates.

Foreign currency exchange risk

We derive all of our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency. However, a significant portion of our headcount related expenses, consisting principally of salaries and related personnel expenses, are denominated in new Israeli shekels, or NIS. This foreign currency exposure gives rise to market risk associated with exchange rate movements of the U.S. dollar against the NIS. Furthermore, we anticipate that a material portion of our expenses will continue to be denominated in NIS. To the extent the U.S. dollar weakens against the NIS, we will experience a negative impact on our profit margins. To manage this risk, we have on occasion converted U.S. dollars into NIS within two to three weeks of monthly pay dates in Israel to lock in the related salary expense given the different currencies. We do not currently engage in currency hedging activities but we may choose to do so in the future. These measures, however, may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

Inflation related risk

We believe that the rate of inflation in Israel has not had a material impact on our business to date. However, our cost in Israel in U.S. dollar terms will increase if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel. Our concentration of credit risk consists principally of cash, cash equivalents and short-term investments. Our exposure to market risk is limited primarily to interest income sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because the majority of our investments are in short-term debt securities. Our investment policy restricts investments to high-quality investments and limits the amounts invested with any one issuer, industry or geographic area. The goals of our investment policy are as follows: preservation of capital; fulfillment of liquidity needs; above-market returns versus industry averages; and fiduciary control of cash and investments. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with an interest rate fixed at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, in accordance with our investment policy, we maintain our portfolio of cash equivalents, short-term marketable securities and restricted cash in a variety of securities, including commercial paper, money market funds, government and non-government debt securities and certificates of deposit. The risk associated with fluctuating interest rates is limited to our investment portfolio. As of March 31, 2007, all of our investments were in money market accounts or overnight repurchase agreements. Due to the short-term nature of these investments, a 5% movement in market interest rates would not have a material impact on the total fair market value of our portfolio as of March 31, 2007.

ITEM 4T ***CONTROLS AND PROCEDURES***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

We are not yet required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. We will be required to comply with Section 404 for the first time, and will be required to provide a management report on internal control over financial reporting, in connection with our Annual Report on Form 10-K for the year ending December 31, 2007. In addition, we will be required to provide both a management report and an independent registered public accounting firm attestation report on internal controls in connection with our Annual Report on Form 10-K for the year ending December 31, 2008. While we are not yet required to comply with Section 404 for this reporting period, we are preparing for future compliance with Section 404 by strengthening, assessing and testing our system of internal controls to provide the basis for our report.

PART II. OTHER INFORMATION

ITEM 1 ***LEGAL PROCEEDINGS***

We are not currently party to any material legal proceedings.

ITEM 1A ***RISK FACTORS***

Investing in our ordinary shares involves a high degree of risk. You should carefully consider the following risk factors, in addition to the other information set forth in this report, before purchasing our ordinary shares. Each of these risk factors could harm our business, financial condition or operating results, as well as decrease the value of an investment in our ordinary shares.

Risks Related to Our Business

We have a history of losses, have only recently become profitable and may not sustain or increase profitability in the future.

We have only recently become profitable, and we first recorded a profit in the year ended December 31, 2005. We incurred net losses prior to the quarter ended June 30, 2005 and incurred a net loss during the quarter ended March 31, 2006. Although we recorded a profit in the three months ended March 31, 2007, as of March 31, 2007 we had an accumulated deficit of approximately $66 million. In addition, we recorded net losses of $15.6 million and $8.9 million for the years ended December 31, 2003 and 2004, respectively. We may not be able to sustain or increase profitability on a quarterly or an annual basis. This may, in turn, cause the price of our ordinary shares to decline. To sustain or increase our profitability, we will need to generate and sustain substantially higher revenues while maintaining reasonable cost and expense levels. We expect to increase expense levels in each of the next several quarters to support increased research and development, sales and marketing and general and administrative efforts. These expenditures may not result in increased revenues or customer growth, and we may not remain profitable.

We do not expect to sustain our recent revenue growth rate, which may reduce our share price.

Our revenues have grown rapidly over the last four years, approximately doubling in size from each of 2003 to 2004 and 2005, and increasing by 15% in 2006. Our revenues increased from $10.2 million to $20.3 million to $42.1 million and to $48.5 million for the years ended December 31, 2003, 2004, 2005 and 2006, respectively. We do not expect to sustain our recent growth rate in future periods. You should not rely on the revenue growth of any prior quarterly or annual periods as an indication of our future performance. If we are unable to maintain adequate revenue growth, we may not have adequate resources to execute our business objectives and our share price may decline.

InfiniBand may not be adopted at the rate or extent that we anticipate, and adoption of InfiniBand is largely dependent on third-party vendors and end users.

While the usage of InfiniBand has increased since its first specifications were completed in October 2000, continued adoption of InfiniBand is dependent on continued collaboration and cooperation among information technology, or IT, vendors. In addition, the end users that purchase IT products and services from vendors must find InfiniBand to be a compelling solution to their IT system requirements. We cannot control third-party participation in the development of InfiniBand as an industry standard technology. We rely on server, storage, communications infrastructure equipment and embedded systems vendors to incorporate and deploy InfiniBand integrated circuits, or ICs, in their systems. InfiniBand may fail to effectively compete with other technologies, which may be adopted by vendors and their customers in place of InfiniBand. The adoption of InfiniBand is also impacted by the general replacement cycle of IT equipment by end users, which is dependent on factors unrelated to InfiniBand. These factors may reduce the rate at which InfiniBand is incorporated by our current server vendor customers and impede its adoption in the storage, communications infrastructure and embedded systems markets, which in turn would harm our ability to sell our InfiniBand products.

We have limited visibility into end-user demand for our products, which introduces uncertainty into our production forecasts and business planning and could negatively impact our financial results.

Our sales are made on the basis of purchase orders rather than long-term purchase commitments. In addition, our customers may defer purchase orders. We place orders with the manufacturers of our products according to our estimates of customer demand. This process requires us to make multiple demand forecast assumptions with respect to both our customers and end users demands. It is more difficult for us to accurately forecast end-user demand because we do not sell our products directly to end users. In addition, the majority of our adapter card business is conducted on a short order fulfillment basis, introducing more uncertainty into our forecasts. Because of the lead time associated with fabrication of our semiconductors, forecasts of demand for our products must be made in advance of customer orders. In addition, we base business decisions regarding our growth on our forecasts for customer demands. As we grow, anticipating customer demand may become increasingly difficult. If we overestimate customer demand, we may purchase products from our manufacturers that we may not be able to sell and may over-budget company operations. Conversely, if we underestimate customer demand or if sufficient manufacturing capacity were unavailable, we would forego revenue opportunities and could lose market share or damage our customer relationships.

We depend on a small number of customers for a significant portion of our sales, and the loss of any of these customers will adversely affect our revenues.

A small number of customers account for a significant portion of our revenues. For the three months ended March 31, 2007, sales to Cisco Systems accounted for 26% of our total revenues, sales to Voltaire accounted for 20% of our total revenues, and sales to Hewlett-Packard accounted for 16% of our total revenues. For the year ended December 31, 2006, sales to Voltaire accounted for 18% of our total revenues, sales to Cisco Systems accounted for 14% of our total revenues, sales to Hewlett-Packard accounted for 12% of our total revenues, and sales to SilverStorm Technologies (which was acquired by QLogic Corporation in October 2006) accounted for 11% of our total revenues. Because the majority of servers, storage, communications infrastructure equipment and embedded systems is sold by a relatively small number of vendors, we expect that we will continue to depend on a small number of customers to account for a significant percentage of our revenues for the foreseeable future. Our customers, including our most significant customers, are not obligated by long-term contracts to purchase our products and may cancel orders with limited potential penalties. If any of our large customers reduces or cancels its purchases from us for any reason, it could have an adverse effect on our revenues and results of operations. For example, one of our largest customers Cisco Systems ordered fewer products from us in the year ended December 31, 2006 as compared to its order history for the year ended December 31, 2005, which resulted in a decrease to revenues from that customer by approximately $11.9 million. In addition, our sales are dependent on our customers sales, and the loss of end-user customers by any of our OEM customers could have an adverse effect on our revenues and results of operations.

We face intense competition and may not be able to compete effectively, which could reduce our market share, net revenues and profit margin.

The markets in which we operate are extremely competitive and are characterized by rapid technological change, continuously evolving customer requirements and declining average selling prices. We may not be able to compete successfully against current or potential competitors. With respect to InfiniBand products, we compete with QLogic Corporation, which recently acquired SilverStorm Technologies. We also compete with providers of alternative technologies, including Ethernet, Fibre Channel and proprietary interconnects. The companies that provide IC products for these alternative technologies include Marvell Technology Group, Broadcom Corporation, Emulex Corporation, QLogic Corporation and Myricom. Many of our current and potential competitors have longer operating histories, significantly greater resources, greater economies of scale, stronger name recognition and larger customer bases than we have. This may allow them to respond more quickly than we are able to respond to new or emerging technologies or changes in customer requirements. In addition, these competitors may have greater credibility with our existing and potential customers. If we do not compete successfully, our market share, revenues and profit margin may decline, and, as a result, our business may be adversely affected.

If we fail to develop new products or enhance our existing products to react to rapid technological change and market demands in a timely and cost-effective manner, our business will suffer.

We must develop new products or enhance our existing products with improved technologies to meet rapidly evolving customer requirements. We are currently engaged in the development process for next generation products, and we need to successfully design our next generation and other products successfully for customers who continually require higher performance and functionality at lower costs. The development process for these advancements is lengthy and will require us to accurately anticipate technological innovations and market trends. Developing and enhancing these products can be time-consuming, costly and complex. Our ability to fund product development and enhancements partially depends on our ability to generate revenues from our existing products. For example, we recently introduced our next generation of products that also support the industry standard Ethernet interconnect specification.

There is a risk that these developments or enhancements, such as migrating our next generation products from 130nm to 90nm and lower silicon process technologies, will be late, fail to meet customer or market specifications and will not be competitive with other products using alternative technologies that offer comparable performance and functionality. We may be unable to successfully develop additional next generation products, new products or product enhancements. Our next generation products that include Ethernet support or any new products or product enhancements may not be accepted in new or existing markets. Our business will suffer if we fail to continue to develop and introduce new products or product enhancements in a timely manner or on a cost-effective basis.

We rely on a limited number of subcontractors to manufacture, assemble, package and production test our products, and the failure of any of these third-party subcontractors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our growth.

While we design and market our products and conduct test development in-house, we do not manufacture, assemble, package and production test our products, and we must rely on third-party subcontractors to perform these services. We currently rely on Taiwan Semiconductor Manufacturing Company, or TSMC, to produce our silicon wafers, and Flextronics International Ltd. to manufacture and production test our adapter cards. We also rely on Advanced Semiconductor Engineering, or ASE, to assemble, package and production test our ICs. If these subcontractors do not provide us with high-quality products, services and production and production test capacity in a timely manner, or if one or more of these subcontractors terminates its relationship with us, we may be unable to obtain satisfactory replacements to fulfill customer orders on a timely basis, our relationships with our customers could suffer, our sales could decrease and our growth could be limited. In particular, there are significant challenges associated with moving our IC production from our existing manufacturer to another manufacturer with whom we do not have a pre-existing relationship.

We currently do not have long-term supply contracts with any of our third-party subcontractors. Therefore, they are not obligated to perform services or supply products to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. None of our third-party subcontractors has provided contractual assurances to us that adequate capacity will be available to us to meet future demand for our products. Our subcontractors may allocate capacity to the production of other companies products while reducing deliveries to us on short notice. Other customers that are larger and better financed than we are or that have long-term agreements with these subcontractors may cause these subcontractors to reallocate capacity to those customers, thereby decreasing the capacity available to us.

Other significant risks associated with relying on these third-party subcontractors include:

reduced control over product cost, delivery schedules and product quality;

potential price increases;

inability to achieve sufficient production, increase production or test capacity and achieve acceptable yields on a timely basis;

increased exposure to potential misappropriation of our intellectual property;

- shortages of materials used to manufacture products;
- capacity shortages;
- labor shortages or labor strikes;
- political instability in the regions where these subcontractors are located; and
- natural disasters impacting these subcontractors.

Our sales cycle can be lengthy, which could result in uncertainty and delays in generating revenues.

We have occasionally experienced a lengthy sales cycle for some of our products, due in part to the constantly evolving nature of the technologies on which our products are based. Some of our products must be custom designed to operate in our customers products, resulting in a lengthy process between the initial design stage and the ultimate sale. We also compete for design wins prior to selling products, which may increase the length of the sales process. We may experience a delay between the time we increase expenditures for research and development, sales and marketing efforts and inventory and the time we generate revenues, if any, from these expenditures. In addition, because we do not have long-term supply contracts with our customers and the majority of our sales are on a purchase order basis, we must repeat our sales process on a continual basis, including sales of new products to existing customers. As a result, our business could be harmed if a customer reduces or delays its orders.

The average selling prices of our products have decreased in the past and may do so in the future, which could harm our financial results.

The products we develop and sell are subject to declines in average selling prices. We have had to reduce our prices in the past to meet market demand, and we may be required to reduce prices in the future. Reductions in our average selling prices to one customer could impact our average selling prices to other customers. This would cause our gross margin to decline. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs or developing new or enhanced products with higher selling prices or gross margin.

Fluctuations in our revenues and operating results on a quarterly and annual basis could cause the market price of our ordinary shares to decline.

Our quarterly and annual revenues and operating results are difficult to predict and have fluctuated in the past, and may fluctuate in the future, from quarter to quarter and year to year. It is possible that our operating results in some quarters and years will be below market expectations. This would likely cause the market price of our ordinary shares to decline. Our quarterly and annual operating results are affected by a number of factors, many of which are outside of our control, including:

- unpredictable volume and timing of customer orders, which are not fixed by contract but vary on a purchase order basis;
- the loss of one or more of our customers, or a significant reduction or postponement of orders from our customers;
- our customers sales outlooks, purchasing patterns and inventory levels based on end-user demands and general economic conditions;
- seasonal buying trends;
- the timing of new product announcements or introductions by us or by our competitors;
- our ability to successfully develop, introduce and sell new or enhanced products in a timely manner;

product obsolescence and our ability to manage product transitions;

changes in the relative sales mix of our products;

decreases in the overall average selling prices of our products;

Table of Contents

- changes in our cost of finished goods; and

- the availability, pricing and timeliness of delivery of other components used in our customers products.

We base our planned operating expenses in part on our expectations of future revenues, and a significant portion of our expenses is relatively fixed in the short-term. We have limited visibility into customer demand from which to predict future sales of our products. As a result, it is difficult for us to forecast our future revenues and budget our operating expenses accordingly. Our operating results would be adversely affected to the extent customer orders are cancelled or rescheduled. If revenues for a particular quarter are lower than we expect, we likely would not proportionately be able to reduce our operating expenses.

We rely primarily upon trade secret, patent and copyright laws and contractual restrictions to protect our proprietary rights, and, if these rights are not sufficiently protected, our ability to compete and generate revenues could suffer.

We seek to protect our proprietary manufacturing specifications, documentation and other written materials primarily under trade secret, patent and copyright laws. We also typically require employees and consultants with access to our proprietary information to execute confidentiality agreements. The steps taken by us to protect our proprietary information may not be adequate to prevent misappropriation of our technology. In addition, our proprietary rights may not be adequately protected because:

- people may not be deterred from misappropriating our technologies despite the existence of laws or contracts prohibiting it;

- policing unauthorized use of our intellectual property may be difficult, expensive and time-consuming, and we may be unable to determine the extent of any unauthorized use; and

- the laws of other countries in which we market our products, such as some countries in the Asia/Pacific region, may offer little or no protection for our proprietary technologies.

Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for doing so. Any inability to adequately protect our proprietary rights could harm our ability to compete, generate revenues and grow our business.

We may not obtain sufficient patent protection on the technology embodied in our products, which could harm our competitive position and increase our expenses.

Our success and ability to compete in the future may depend to a significant degree upon obtaining sufficient patent protection for our proprietary technology. As of March 31, 2007, we had 12 issued patents and 25 patent applications pending in the United States, 5 issued patents in Taiwan and 6 applications pending in Israel, each of which covers aspects of the technology in our products. Patents that we currently own do not cover all of the products that we presently sell. Our patent applications may not result in issued patents, and even if they result in issued patents, the patents may not have claims of the scope we seek. Even in the event that these patents are not issued, the applications may become publicly available and proprietary information disclosed in the applications will become available to others. In addition, any issued patents may be challenged, invalidated or declared unenforceable. The term of any issued patent in the United States would be 20 years from its filing date, and if our applications are pending for a long time period, we may have a correspondingly shorter term for any patent that may be issued. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantages to us. For example, competitors could be successful in challenging any issued patents or, alternatively, could develop similar or more advantageous technologies on their own or design around our patents. Also, patent protection in certain foreign countries may not be available or may be limited in scope and any patents obtained may not be as readily enforceable as in the United States and Israel, making it difficult for us to effectively protect our intellectual property from misuse or infringement by other companies in these countries. Our inability to obtain and enforce our intellectual property rights in some countries may harm our business. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important.

Intellectual property litigation, which is common in our industry, could be costly, harm our reputation, limit our ability to sell our products and divert the attention of management and technical personnel.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. We have indemnification obligations to most of our customers with respect to infringement of third-party patents and intellectual property rights by our products. If litigation were to be filed against these customers in connection with our technology, we may be required to defend and indemnify such customers.

Questions of infringement in the markets we serve involve highly technical and subjective analyses. Although we have not been involved in intellectual property litigation to date, litigation may be necessary in the future to enforce any patents we may receive and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity, and we may not prevail in any such future litigation. Litigation, whether or not determined in our favor or settled, could be costly, could harm our reputation and could divert the efforts and attention of our management and technical personnel from normal business operations. In addition, adverse determinations in litigation could result in the loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from third parties or prevent us from licensing our technology or selling our products, any of which could seriously harm our business.

We depend on key and highly skilled personnel to operate our business, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed.

Our business is particularly dependent on the interdisciplinary expertise of our personnel, and we believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, finance and sales and marketing personnel. The loss of any key employees or the inability to attract or retain qualified personnel could delay the development and introduction of, and harm our ability to sell, our products and harm the market s perception of us. Competition for qualified engineers in the markets in which we operate, primarily in Israel where our engineering operations are based, is intense and, accordingly, we may not be able to retain or hire all of the engineers required to meet our ongoing and future business needs. If we are unable to attract and retain the highly skilled professionals we need, we may have to forego projects for lack of resources or be unable to staff projects optimally. We believe that our future success is highly dependent on the contributions of Eyal Waldman, our president and chief executive officer. We do not have long-term employment contracts with Mr. Waldman or any other key personnel, and their knowledge of our business and industry would be extremely difficult to replace.

We may not be able to manage our future growth effectively, and we may need to incur significant expenditures to address the additional operational and control requirements of our growth.

We are experiencing a period of growth and expansion. This expansion has placed, and any future expansion will continue to place, a significant strain on our management, personnel, systems and financial resources. We plan to hire additional employees to support an increase in research and development as well as increases in our sales and marketing and general and administrative efforts. To successfully manage our growth and handle the responsibilities of being a public company, we believe we must effectively:

- continue to enhance our customer relationship and supply chain management and supporting systems;
- implement additional and improve existing administrative, financial and operations systems, procedures and controls;
- expand and upgrade our technological capabilities;
- manage multiple relationships with our customers, distributors, suppliers, end users and other third parties;
- manage the mix of our U.S., Israeli and other foreign operations; and
- hire, train, integrate and manage additional qualified engineers for research and development activities, sales and marketing personnel and financial and IT personnel.

Our efforts may require substantial managerial and financial resources and may increase our operating costs even though these efforts may not be successful. If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities, develop new products, satisfy customer requirements, execute our business plan or respond to competitive pressures.

We may experience defects in our products, unforeseen delays, higher than expected expenses or lower than expected manufacturing yields of our products, which could result in increased customer warranty claims, delay

our product shipments and prevent us from recognizing the benefits of new technologies we develop.

Although we test our products, they are complex and may contain defects and errors. In the past we have encountered defects and errors in our products. Delivery of products with defects or reliability, quality or compatibility problems may damage our reputation and our ability to retain existing customers and attract new customers. In addition, product defects and errors could result in additional development costs, diversion of technical resources, delayed product shipments, increased product returns, warranty expenses and product liability claims against us which may not be fully covered by insurance. Any of these could harm our business.

Table of Contents

In addition, our production of existing and development of new products can involve multiple iterations and unforeseen manufacturing difficulties, resulting in reduced manufacturing yields, delays and increased expenses. The evolving nature of our products requires us to modify our manufacturing specifications, which may result in delays in manufacturing output and product deliveries. We rely on third parties to manufacture our products and currently rely on one manufacturer for our ICs and one manufacturer for our cards. Our ability to offer new products depends on our manufacturers ability to implement our revised product specifications, which is costly, time-consuming and complex.

If we fail to maintain an effective system of internal controls, we may not be able to report accurately our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our ordinary shares.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. In addition, Section 404 of the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley, requires us to evaluate and report on our internal control over financial reporting and have our independent registered public accounting firm annually attest to our evaluation, as well as issue its own opinion on our internal control over financial reporting. The Section 404 internal control reporting requirements will be implemented according to the regulatory phase-in schedule of the Securities and Exchange Commission. The SEC recently adopted rules to delay the implementation of Section 404 compliance for new public companies. Under the SEC s new rules, we will be required to provide a management report on internal control over financial reporting for the first time in connection with our Annual Report on Form 10-K for the year ending December 31, 2007. We will be required to provide both a management report and an independent registered public accounting firm attestation report on internal controls in connection with our Annual Report on Form 10-K for the year ending December 31, 2008. We are preparing for compliance with Section 404 by strengthening, assessing and testing our system of internal controls to provide the basis for our report. However, the continuous process of strengthening our internal controls and complying with Section 404 is expensive and time-consuming and requires significant management attention. We cannot be certain that these measures will ensure that we will maintain adequate control over our financial processes and reporting. Furthermore, as we grow our business, our internal controls will become more complex and will require significantly more resources to ensure our internal controls remain effective overall. Failure to implement new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market s confidence in our financial statements and harm our share price. In addition, future non-compliance with Section 404 could subject us to a variety of administrative sanctions, including the suspension or delisting of our ordinary shares from The Nasdaq Global Market, which could reduce our share price.

We may pursue acquisitions or investments in complementary products, technologies and businesses, which could harm our operating results and may disrupt our business.

In the future, we may pursue acquisitions of, or investments in, complementary products, technologies and businesses. Acquisitions present a number of potential risks and challenges that could, if not met, disrupt our business operations, increase our operating costs and reduce the value to us of the acquisition. For example, if we identify an acquisition candidate, we may not be able to successfully negotiate or finance the acquisition on favorable terms. Even if we are successful, we may not be able to integrate the acquired businesses, products or technologies into our existing business and products. Furthermore, potential acquisitions and investments, whether or not consummated, may divert our management s attention and require considerable cash outlays at the expense of our existing operations. In addition, to complete future acquisitions, we may issue equity securities, incur debt, assume contingent liabilities or have amortization expenses and write-downs of acquired assets, which could adversely affect our profitability.

Changes to financial accounting standards may affect our results of operations and cause us to change our business practices.

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the Financial Accounting Standards Board, or FASB, the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, accounting policies affecting many aspects of our business, including rules relating to employee share option grants, have recently been revised. The FASB and other agencies have made changes to GAAP that required us, as of our first quarter of 2006, to record a charge to earnings for the estimated fair value of employee share option grants and other equity incentives, whereas under previous accounting rules charges were required only for the intrinsic value, if any, of such awards to employees. We may have significant and ongoing accounting charges under the new rules resulting from option grants and other equity incentive expensing that could reduce our net income. In addition, since historically we have used equity-related compensation as a component of our total employee compensation program, the accounting change could make the use of equity-related compensation less attractive to us and therefore make it more difficult for us to attract and retain employees.

Our business is subject to the risks of earthquakes, fires, floods and other natural catastrophic events, and to interruption by manmade problems such as computer viruses or terrorism.

Our U.S. corporate offices are located in the San Francisco Bay Area, a region known for seismic activity. A significant natural disaster, such as an earthquake, fire or flood, could have a material adverse impact on our business, operating results and financial condition. In addition, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. In addition, acts of terrorism could cause disruptions in our or our customers businesses or the economy as a whole. To the extent that such disruptions result in delays or cancellations of customer orders, or the deployment of our products, our business, operating results and financial condition would be adversely affected.

Risks Related to Our Industry

Due to the cyclical nature of the semiconductor industry, our operating results may fluctuate significantly, which could adversely affect the market price of our ordinary shares.

The semiconductor industry is highly cyclical and subject to rapid change and evolving industry standards and, from time to time, has experienced significant downturns. These downturns are characterized by decreases in product demand, excess customer inventories and accelerated erosion of prices. These factors could cause substantial fluctuations in our net revenues and in our operating results. Any downturns in the semiconductor industry may be severe and prolonged, and any failure of this industry to fully recover from downturns could harm our business. The semiconductor industry also periodically experiences increased demand and production capacity constraints, which may affect our ability to ship products. Accordingly, our operating results may vary significantly as a result of the general conditions in the industry, which could cause our share price to decline.

The demand for semiconductors is affected by general economic conditions, which could impact our business.

The semiconductor industry is affected by general economic conditions, and a downturn may result in decreased demand for our products and adversely affect our operating results. Our business has been adversely affected by previous economic downturns. For example, during the global economic downturn in 2002 to 2003, demand for many computer and consumer electronics products suffered as consumers delayed purchasing decisions or changed or reduced their discretionary spending. As a result, demand for our products suffered and we had to implement restructuring initiatives to align our corporate spending with a slower than anticipated revenue growth during that timeframe.

The semiconductor industry is highly competitive, and we cannot assure you that we will be able to compete successfully against our competitors.

The semiconductor industry is highly competitive. Increased competition may result in price pressure, reduced profitability and loss of market share, any of which could seriously harm our revenues and results of operations. Competition principally occurs at the design stage, where a customer evaluates alternative design solutions. We continually face intense competition from semiconductor interconnect solutions companies. Some of our competitors have greater financial and other resources than we have with which to pursue engineering, manufacturing, marketing and distribution of their products. As a result, they may be able to respond more quickly to changing customer demands or devote greater resources to the development, promotion and sales of their products than we can. We cannot assure you that we will be able to increase or maintain our revenues and market share, or compete successfully against our current or future competitors in the semiconductor industry.

Risks Related to Operations in Israel and Other Foreign Countries

Regional instability in Israel may adversely affect business conditions and may disrupt our operations and negatively affect our revenues and profitability.

We have engineering facilities and corporate and sales support operations and, as of March 31, 2007, 138 full-time and 26 part-time employees located in Israel. Substantially all of our assets are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest. During the summer of 2006,

Table of Contents

Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party. This conflict involved missile strikes against civilian targets in northern Israel, and negatively affected business conditions in Israel. In addition, Israel and companies doing business with Israel have, in the past, been the subject of an economic boycott. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, Israel has been and is subject to civil unrest and terrorist activity, with varying levels of severity, since September 2000. The election in early 2006 of representatives of the Hamas movement to a majority of seats in the Palestinian Legislative Council and the tension among the different Palestinian factions may create additional unrest and uncertainty. Any future armed conflicts or political instability in the region may negatively affect business conditions and adversely affect our results of operations. Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements when necessary. In addition, the political and security situation in Israel may result in parties with whom we have agreements involving performance in Israel claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions in the agreements.

We can give no assurance that security and political conditions will have no impact on our business in the future. Hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital. While we did not sustain damages from the recent conflict with Hezbollah referred to above, our Israeli operations, which are located in northern Israel, are within range of Hezbollah missiles and we or our immediate surroundings may sustain damages in a missile attack, which could adversely affect our operations.

In addition, our business insurance does not cover losses that may occur as a result of events associated with the security situation in the Middle East. Although the Israeli government currently covers the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained. Any losses or damages incurred by us could have a material adverse effect on our business.

Our operations may be negatively affected by the obligations of our personnel to perform military service.

Generally, all non-exempt male adult citizens and permanent residents of Israel under the age of 45 (or older, for citizens with certain occupations), including some of our officers, directors and employees, are obligated to perform military reserve duty annually, and are subject to being called to active duty at any time under emergency circumstances. In the event of severe unrest or other conflict, individuals could be required to serve in the military for extended periods of time. In response to increases in terrorist activity, there have been periods of significant call-ups of military reservists, and recently some of our employees, including those in key positions, have been called up in connection with armed conflicts. It is possible that there will be additional call-ups in the future. Our operations could be disrupted by the absence for a significant period of one or more of our officers, directors or key employees due to military service. Any such disruption could adversely affect our operations.

Our operations may be affected by negative economic conditions or labor unrest in Israel.

Due to significant economic measures adopted by the Israeli government, there were several general strikes and work stoppages in Israel in 2003 and 2004, affecting all banks, airports and ports. These strikes have had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers and to receive raw materials from our suppliers in a timely manner. From time to time, the Israeli trade unions threaten strikes or work stoppages, which, if carried out, may have a material adverse effect on the Israeli economy and our business.

We are susceptible to additional risks from our international operations.

We have derived, and will likely continue to derive, a significant portion of our revenues from sales outside North America. As a result, we face additional risks from doing business internationally, including:

- reduced protection of intellectual property rights in some countries;
- licenses, tariffs and other trade barriers;
- difficulties in staffing and managing foreign operations;
- longer sales and payment cycles;

- greater difficulties in collecting accounts receivable;
- seasonal reductions in business activity;
- potentially adverse tax consequences;
- laws and business practices favoring local competition;
- costs and difficulties of customizing products for foreign countries;
- compliance with a wide variety of complex foreign laws and treaties;
- tariffs, trade barriers, transit restrictions and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- fluctuations in freight rates and transportation disruptions;
- political and economic instability; and
- variance and unexpected changes in local laws and regulations.

Our principal research and development facilities are located in Israel, and our directors, executive officers and other key employees are located primarily in Israel and the United States. In addition, we engage sales representatives in various countries throughout the world to market and sell our products in those countries and surrounding regions. If we encounter these challenges in our international operations, we could experience slower than expected revenue growth and our business could be harmed.

It may be difficult to enforce a U.S. judgment against us, our officers and directors and some of the experts named in the prospectus relating to the initial public offering of our ordinary shares or to assert U.S. securities law claims in Israel.

We are incorporated in Israel. Four of our executive officers and one of our directors, who is also an executive officer, and some of our accountants and attorneys are non-residents of the United States and are located in Israel, and substantially all of our assets and the assets of these persons are located outside the United States. Three of our executive officers and five of our directors are located in the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of these persons in U.S. or Israeli courts based on the civil liability provisions of the U.S. federal securities laws.

In addition, we have been informed by our legal counsel in Israel, Yigal Arnon & Co., that it may be difficult for a shareholder to enforce civil liabilities under U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws 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 in court as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing the matters described above.

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

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. For example, a merger may not be completed unless at least 50 days have passed from the date that a merger proposal was filed by each merging company with the Israel Registrar of Companies and at least 30 days from the date that the shareholders of both merging companies approved the merger. In addition, the approval of a majority of each class of securities of the target company is required to approve a merger. Israeli corporate law further requires that any person who wishes to acquire more than a specified percentage of the company s share capital complies with certain tender offer procedures. In addition, Israeli corporate law allows us to create and issue shares having rights different from those attached to our ordinary shares, including rights that may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares would require an amendment to our articles of association, which requires the prior approval of the holders of a majority of our shares at a general meeting.

These provisions could delay, prevent or impede an acquisition of us, even if such an acquisition would be considered beneficial by some of our shareholders. See Risk Factors Provisions of our charter documents or Israeli law could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our shareholders, and could make it more difficult for shareholders to change management for a further discussion of this risk factor.

Exchange rate fluctuations between the U.S. dollar and the NIS may negatively affect our earnings.

Although most of our revenues and a majority of our expenses are denominated in U.S. dollars, a significant portion of our research and development expenses are incurred in new Israeli shekels, or NIS. As a result, we are exposed to risk to the extent that the inflation rate in Israel exceeds the rate of devaluation of the NIS in relation to the U.S. dollar or if the timing of these devaluations lags behind inflation in Israel. In that event, the U.S. dollar cost of our research and development operations in Israel will increase and our U.S. dollar-measured results of operations will be adversely affected. To the extent that the value of the NIS increases against the U.S. dollar, our expenses on a U.S. dollar cost basis increase. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation of the NIS against the U.S. dollar. The Israeli rate of inflation (deflation) amounted to 1.2%, 2.4% and (0.1)% for the years ended December 31, 2004, 2005 and 2006, respectively. If the U.S. dollar cost of our research and development operations in Israel increases, our dollar-measured results of operations will be adversely affected. Our operations also could be adversely affected if we are unable to guard against currency fluctuations in the future. Further, because most of our international revenues are denominated in U.S. dollars, a strengthening of the dollar versus other currencies could make our products less competitive in foreign markets and collection of receivables more difficult. We do not currently engage in currency hedging activities but we may choose to do so in the future. These measures, however, may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

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

Some of our operations in Israel have been granted Approved Enterprise status by the Investment Center in the Israeli Ministry of Industry Trade and Labor, which makes us eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959. The availability of these tax benefits is subject to certain requirements, including, among other things, making specified investments in fixed assets and equipment, financing a percentage of those investments with our capital contributions, complying with our marketing program which was submitted to the Investment Center, filing of certain reports with the Investment Center and complying with Israeli intellectual property laws. If we do not meet these requirements in the future, these tax benefits may be cancelled and we could be required to refund any tax benefits that we have already received plus interest and penalties thereon. The tax benefits that our current Approved Enterprise program receives may not be continued in the future at their current levels or at all. If these tax benefits were reduced or eliminated, the amount of taxes that we pay would likely increase, which could adversely affect our results of operations. Additionally, if we increase our activities outside of Israel, for example, by acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefit programs.

The Israeli government grants that we received require us to meet several conditions, and these grants restrict our ability to manufacture and engineer products and transfer know-how outside of Israel and require us to satisfy specified conditions.

We have received, and may receive in the future, grants from the government of Israel through the Office of the Chief Scientist of Israel s Ministry of Industry, Trade and Labor, or the OCS, for the financing of a portion of our research and development expenditures in Israel. When know-how or products are developed using OCS grants, the terms of these grants restrict the transfer of the know-how out of Israel. Transfer of know-how abroad is subject to various conditions, including payment of a percentage of the consideration paid to us or our shareholders in the transaction in which the technology is transferred. In addition, any decrease of the percentage of manufacturing performed locally, as originally declared in the application to the OCS, may require us to notify, or to obtain the approval of the OCS, and may result in increased royalty payments to the OCS. These restrictions may impair our ability to enter into agreements for those products or technologies without the approval of the OCS. We cannot be certain that any approval of the OCS will be obtained on terms that are acceptable to us, or at all. Furthermore, in the event that we undertake a transaction involving the transfer to a non-Israeli entity of technology developed with OCS funding pursuant to a merger or similar transaction, the consideration available to our shareholders may be reduced by the amounts we are required to pay to the OCS. Any approval, if given, will generally be subject to additional financial obligations. If we fail to comply with the conditions imposed by the OCS, including the payment of royalties with respect to grants received, we may be required to refund any payments previously received, together with interest and penalties. In the years ended December 31, 2004 and 2005, the OCS approved grants totaling $1.3 million and $43,000, respectively, of funding in support of some of our research and development programs. No grants to us were approved by the OCS in the year ended December 31, 2006 or the three months ended March 31, 2007.

We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. holders of our ordinary shares.

We do not expect to be considered a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our current taxable year ending December 31, 2007. However, the application of the PFIC rules is subject to ambiguity in several respects, and, in addition, we must make a separate determination each taxable year as to whether we are a PFIC (after the close of each taxable year). Accordingly, we cannot assure you that we will not be a PFIC for our current taxable year or any future taxable year. A non-U.S. corporation will be considered a PFIC for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) at least 50% of the value of its assets is attributable to assets that produce or are held for the production of passive income. The market value of our assets generally will be determined based on the market price of our ordinary shares, which has fluctuated since our ordinary shares began trading on the NASDAQ Global Market on February 8, 2007 and is likely to fluctuate in the future. In addition, the composition of our income and assets will be affected by how, and how quickly, we spend the cash we raised in our initial public offering. If we were treated as a PFIC for any taxable year during which a U.S. person held an ordinary share, certain adverse U.S. federal income tax consequences could apply to such U.S. person, including:

- having gains realized on the sale of our ordinary shares treated as ordinary income, rather than capital gain;
- the loss of the preferential rate applicable to dividends received on our ordinary shares by individuals who are U.S. holders; and
- having interest charges apply to the proceeds of share sales.

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our amended and restated articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters.

Risks Related to Our Ordinary Shares

The price of our ordinary shares may continue to be volatile, and the value of an investment in our ordinary shares may decline.

We sold ordinary shares in our initial public offering in February 2007 at a price of $17.00 per share, and our shares have subsequently traded as low as $13.70 per share. An active and liquid trading market for our ordinary shares may not develop or be sustained. Factors that could cause volatility in the market price of our ordinary shares include, but are not limited to:

- quarterly variations in our results of operations or those of our competitors;
- announcements by us or our customers of acquisitions, new products, significant contracts, commercial relationships or capital commitments;
- our ability to develop and market new and enhanced products on a timely basis;
- disruption to our operations;
- geopolitical instability;
- the emergence of new sales channels in which we are unable to compete effectively;

any major change in our board of directors or management;

changes in financial estimates, including our ability to meet our future revenue and operating profit or loss projections;

changes in governmental regulations or in the status of our regulatory approvals;

general economic conditions and slow or negative growth of related markets;

commencement of, or our involvement in, litigation; and

changes in earnings estimates or recommendations by securities analysts.

In addition, the stock markets in general, and the markets for semiconductor stocks in particular, have experienced extreme volatility that often has been unrelated to the operating performance of the issuer. These broad market fluctuations may adversely affect the trading price or liquidity of our ordinary shares. In the past, when the market price of a stock has been volatile and declined, holders of that stock have sometimes instituted securities class action litigation against the issuer. If any of our shareholders were to bring such a lawsuit against us, we could incur substantial costs defending the lawsuit and the attention of our management would be diverted from the operation of our business.

The ownership of our ordinary shares will continue to be highly concentrated, and your interests may conflict with the interests of our existing shareholders.

Our executive officers and directors and their affiliates, together with our current significant shareholders, beneficially owned approximately 35% of our outstanding ordinary shares as of March 31, 2007. Moreover, four of our shareholders, Sequoia Capital Partners, U.S. Venture Partners, Intel Atlantic, Inc. and Bessemer Venture Partners, beneficially owned approximately 27% of our outstanding ordinary shares as of March 31, 2007. In addition, individual partners of U.S. Venture Partners and Bessemer Venture Partners serve on our board of directors. Accordingly, these shareholders, acting as a group, have significant influence over the outcome of corporate actions requiring shareholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction. These shareholders could delay or prevent a change of control of our company, even if such a change of control would benefit our other shareholders. The significant concentration of share ownership may adversely affect the trading price of our ordinary shares due to investors perception that conflicts of interest may exist or arise.

A significant portion of our outstanding ordinary shares may be sold into the market in the near future. Substantial sales of our shares, or the perception such sales are likely to occur, could cause the price of our ordinary shares to decline.

If our existing shareholders sell a large number of our ordinary shares or the public market perceives that existing shareholders might sell our ordinary shares, the market price of our ordinary shares could decline significantly. Approximately 22.8 million ordinary shares may be sold upon the expiration of lock-up agreements in August 2007. Existing shareholders holding an aggregate of approximately 15.1 million ordinary shares have rights with respect to the registration of these ordinary shares with the SEC. If we register their ordinary shares following the expiration of the lock-up agreements, they can sell those shares in the public market.

If we sell our ordinary shares in future financings, ordinary shareholders will experience immediate dilution and, as a result, our share price may go down.

We may from time to time issue additional ordinary shares at a discount from the current trading price of our ordinary shares. As a result, our ordinary shareholders would experience immediate dilution upon the purchase of any ordinary shares sold at such discount. In addition, as opportunities present themselves, we may enter into equity financings or similar arrangements in the future, including the issuance of debt securities, preferred shares or ordinary shares. If we issue ordinary shares or securities convertible into ordinary shares, our ordinary shareholders could experience dilution.

Provisions of our charter documents or Israeli law could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our shareholders, and could make it more difficult for shareholders to

change management.

Provisions of our amended and restated articles of association may discourage, delay or prevent a merger, acquisition or other change in control that shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares. In addition, these provisions may frustrate or prevent any attempt by our shareholders to replace or remove our current management by making it more difficult to replace or remove our board of directors. These provisions include:

- no cumulative voting; and
- an advance notice requirement for shareholder proposals and nominations.

Furthermore, Israeli tax law treats some acquisitions, particularly stock-for-stock swaps between an Israeli company and a foreign company, less favorably than U.S. tax law. Israeli tax law generally provides that a shareholder who exchanges our shares for shares in a foreign corporation is treated as if the shareholder has sold the shares. In such a case, the shareholder will generally be subject to Israeli taxation on any capital gains from the sale of shares (after two years, with respect to one half of the shares, and after four years, with respect to the balance of the shares, in each case unless the shareholder sells such shares at an earlier date), unless a relevant tax treaty between Israel and the country of the shareholder s residence exempts the shareholder from Israeli tax. Please see Risk Factors Provisions of Israeli law may delay, prevent or make difficult an acquisition of us, which could prevent a change of control and therefore depress the price of our shares for a further discussion of Israeli laws relating to mergers and acquisitions. These provisions in our amended and restated articles of association and other provisions of Israeli law could limit the price that investors are willing to pay in the future for our ordinary shares.

We have never paid cash dividends on our share capital, and we do not anticipate paying any cash dividends in the foreseeable future.

We have never declared or paid cash dividends on our share capital, nor do we anticipate paying any cash dividends on our share capital in the foreseeable future. We currently intend to retain all available funds and any future earnings to fund the development and growth of our business. As a result, capital appreciation, if any, of our ordinary shares will be your sole source of gain for the foreseeable future.

We may incur increased costs as a result of changes in laws and regulations relating to corporate governance matters.

Changes in the laws and regulations affecting public companies, including the provisions of Sarbanes-Oxley and rules adopted by the SEC and by The Nasdaq Stock Market, will result in increased costs to us as we respond to their requirements. These laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers. We cannot predict or estimate the amount or timing of additional costs we may incur to respond to these requirements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities

We have issued and sold the following unregistered securities during the three months ended March 31, 2007. The following share numbers have been adjusted to reflect the Reverse Share Split (as defined in Note 1 of the accompanying notes to our consolidated financial statements included in this report) and the conversion of preferred shares into ordinary shares effected immediately prior to the completion of the initial public offering, or IPO, of 6,900,000 shares of our ordinary shares, which occurred on February 13, 2007.

1. We issued an aggregate of 42,263 ordinary shares to employees, directors and consultants for cash consideration in the aggregate amount of $221,991 upon the exercise of share options and share awards.

We claimed exemption from registration under the Securities Act of 1933, as amended, or the Securities Act , for the sales and issuances of securities in the transactions described above under Rule 701 promulgated under the Securities Act, in that they were offered and sold either pursuant to written compensatory plans or pursuant to a written contract relating to compensation, as provided by Rule 701.

(b) Use of Proceeds

The IPO was effected through a Registration Statement on Form S-1 (Reg. No. 333-137659) which was declared effective by the Securities and Exchange Commission on February 7, 2007. We issued 6,900,000 shares on February 13, 2007 for gross proceeds of $117.3 million. The Company paid the underwriters a commission of $8.2 million and incurred additional offering costs of

Table of Contents

approximately $3.1 million. After deducting the underwriters commission and the offering costs, the Company received net proceeds of approximately $106 million. The managing underwriters of our IPO were Credit Suisse Securities (USA) LLC and J.P. Morgan Securities Inc.

No payments for such costs were made directly or indirectly to (i) any of our directors, officers or their associates, (ii) any person(s) owning 10% or more of any class of our equity securities or (iii) any of our affiliates.

The net proceeds have been invested into short-term investment grade repurchase agreements and money market funds. We intend to use the net proceeds of the IPO to fund development of our products and for general corporate purposes, including working capital, sales and marketing activities, general and administrative matters and capital expenditures. We may also use a portion of the net proceeds to acquire or invest in complementary technologies, products or businesses or to obtain rights to such complementary technologies, products or businesses. There are no such transactions under consideration at this time.

(c) Repurchases of Equity Securities

None.

ITEM 3 ***DEFAULTS UPON SENIOR SECURITIES***

Not applicable.

ITEM 4 ***SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

No matters were submitted to a vote of security holders during the period covered by this report.

ITEM 5 ***OTHER INFORMATION***

Not applicable.

ITEM 6 ***EXHIBITS***

31.1 Certification of the Company s Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Company s Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Company s Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Company s Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Page 34

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized as of the 8th day of May, 2007.

Mellanox Technologies, Ltd.

/s/ Michael Gray

Michael Gray
Chief Financial Officer

(Duly Authorized Officer and Principal Financial Officer)

Table of Contents

Exhibit Index

31.1	Certification of the Company s Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Company s Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Company s Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Company s Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.